1999

Valuing intellectual property and calculating infringement damages : a nonauthoritative guide; Consulting services practice aid, 99-2

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Valuing Intellectual Property and Calculating Infringement Damages

AICPA

CONSULTING SERVICES PRACTICE AID 99-2

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Technical Consulting

Valuing Intellectual Property and Calculating Infringement Damages

A Nonauthoritative Guide

Consulting Services Team

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This Practice Aid is designed as educational and reference material for AICPA members and others who provide consulting services as defined in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA. It does not establish standards or preferred practices. Other approaches, methodologies, procedures, and presentations may be appropriate because of the widely varying nature of management consulting services as well as specific or unique facts about the client and engagement. Readers may need to consult with counsel about local requirements and state laws that may differ from the general guidance contained in the Practice Aid.

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Various members of the 1997-98 AICPA Business Valuations and Appraisals Subcommittee provided information for this Practice Aid and advised the author and staff. The subcommittee members are listed below.

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PREFACE

This practice aid is one of a series intended to assist practitioners in applying their knowledge of organizational functions and technical disciplines in the course of providing consulting services. Although these practice aids often deal with aspects of consulting services knowledge in the context of a consulting engagement, they are also intended to be useful to practitioners who provide advice on the same subjects in the form of consultation. Consulting services engagements and consultations are defined in the Statement on Standards for Consulting Services (SSCS), *Consulting Services: Definitions and Standards,* issued by the AICPA.

This series of technical consulting practice aids should be particularly helpful to practitioners who use the expertise of others while remaining responsible for the work performed. It may also prove useful to members in industry and government in providing advice and assistance to management.

Technical consulting practice aids do not purport to include everything a practitioner needs to know or do to undertake a specific type of service. Furthermore, engagement circumstances differ and therefore the practitioner's professional judgment may cause him or her to conclude that an approach described in a particular practice aid is inappropriate.

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VALUING INTELLECTUAL PROPERTY AND CALCULATING INFRINGEMENT DAMAGES

1. INTRODUCTION AND SCOPE OF PRACTICE AID

Intent of This Practice Aid

.01 The objective of this practice aid is to serve as a useful source of information that will provide the practitioner who has the necessary business valuation experience with some guidance in valuing intellectual economic property and its management and licensing. This practice aid will focus on the theoretical, legal, economic, and accounting basis of intellectual property and intangible assets; the appropriate methodologies to be employed in the valuation process; and on the calculation of infringement damages.

.02 The practice aid will also discuss pertinent tax legislation that is relevant to intellectual property. In addition, appendix C, "Summary of Cases Classified by Intangible Asset," gives the relevant case law classified by intangible asset generally and intellectual property specifically. The practitioner can refer to this list of cases for a particular asset to gain further insight as to the methods and procedures accepted by the courts. However, the certified public accountant (CPA) is cautioned that the court cases are only general guidance and that the facts and circumstances of each case are different. Wherever possible, the practice aid will provide examples of the approaches discussed. In addition to the "Bibliography," there is a comprehensive list of primary source data, in the appendices attached.

Overview

.03 The ability to value, manage, and exploit intangible assets has become a significant corporate objective for most firms.

.04 We now operate in an economy that is driven by knowledge. Terms such as *intellectual capital* and objectives such as leveraging intellectual capital are being addressed as strategic corporate objectives for the twenty-first century. In fact, one Swedish insurance company has the official corporate position of "Director of Intellectual Capital" and publishes as part of its annual report an analysis of the corporate intellectual capital, which is meant to measure the assets employed by a company but not reflected on the company's balance sheet.

.05 Intellectual property and intangible assets are part of intellectual capital and part of what companies will need to manage to effectively compete in the future. Statistics show that companies now spend more for information than they do to attract capital. Tangible assets such as land and factories—traditional brick and mortars—tie up capital and do not provide the returns that a business core competency is expected to return. One empirical research study shows this by comparing the annual cost of equity capital with the information expenses, for nearly three thousand U.S. companies, using sales, and general and administrative costs as a reasonable proxy. More than 90 percent of the companies spent more for information. The few exceptions were steel, mining, transportation, and real estate businesses. The median company paid nearly five times more; one shop, a consulting firm, had a 32 to 1 ratio.[1]

.06 Identifying intangible assets and protecting intellectual property are necessary steps for success. However, unlocking the value of these assets and understanding the management process is necessary groundwork.

.07 CPAs with specialized training in consulting and valuation can be an integral part of providing the client with the necessary tools to best meet each of these steps. Along these lines, the practitioner can effectively service clients by helping them manage their assets better by providing valuation services, assistance in license negotiations, calculating infringement damages, if called upon to do so. A few decades ago, CPAs started helping their clients with capital budgeting and financing. In the future, they are going to be in knowledge management.

Distinction Between Intellectual Property and Intangible Assets

.08 Intangible assets are long-lived assets used in the production of goods and services and are similar to fixed or tangible assets except for their lack of physical properties. Intangible assets represent certain long-lived legal rights or competitive advantages developed or acquired by a business enterprise. They differ considerably in their characteristics, useful lives, and relationship to the operations of an enterprise and are classified in the various pronouncements by the Accounting Principles Board and the Financial Accounting Standards Board along with various accounting technical bulletins and interpretations.

- *Identifiability.* Patents, copyrights, franchises, trademarks, and other similar intangible assets can be specifically identified with reasonably descriptive names.
- *Manner of acquisition.* Intangible assets may be purchased or developed internally.
- *Determinate or indeterminate life.* Many intangible assets will have a determinate life established by law or by contract.
- *Transferability.* The right to patent, copyright, or franchise can be identified separately and bought or sold.

.09 For valuation purposes, it is usually helpful if the intangible assets are readily identifiable and capable of being separated from the other assets employed in the business. An intangible asset can be defined by referring to practical considerations such as whether it is supported by a contract or other legal right, or by referring to whether it can be measured objectively with a determinate life.

.10 The analyst should perform adequate research to ascertain whether a particular definition is appropriate to the subject intangible asset analysis, given the following:

- The particular purpose and objective of the valuation
- The particular jurisdiction or venue in which the discrete intangible assets exist

.11 For purposes of this discussion, we will focus on the definitional questions that are relevant to the economic analysis and to the valuation of discrete intangible assets. Accordingly, from this valuation perspective, the analyst may consider the following two definitional questions.

[1] Thomas P. Stewart. *Intellectual Capital The New Wealth of Organization* New York: Bantam Doubleday, 1998, page 34.

1. What economic phenomenon qualifies as a discrete intangible asset?
2. What economic phenomenon is indicative of value in a discrete intangible asset?

.12 For a discrete intangible asset to exist from a valuation or economic perspective, typically it should possess certain attributes. The more common attributes include that the asset may—

- Be subject to specific identification and recognizable description.
- Be subject to legal existence and protection.
- Be subject to the right of private ownership, and this private ownership may be legally transferable.
- Include some tangible evidence or manifestation of the existence of the intangible asset (for example, a contract, a license, a registration document, a computer diskette, a set of procedural documentation, a listing of customers, a set of financial statements).
- Have been created or have come into existence as an identifiable item or as the result of an identifiable event.

In other words, there should be a specific bundle of rights (and other natural properties) associated with the existence of any discrete intangible asset.

.13 For a discrete intangible asset to have a quantifiable value in terms of an economic analysis or appraisal, it should possess certain additional attributes. Some of the more common additional attributes include the following.

- It should generate some measurable amount of economic benefit to its owner; this economic benefit could be in the form of an income increment or of a cost decrement; this economic benefit is sometimes measured by comparison to the amount of income otherwise available to the intangible asset owner (for example, the business) if the subject intangible asset did not exist.
- This economic benefit may be measured in any of several ways, including net income or net operating income or net cash flow, and so on.
- It should be able to enhance the value of the other assets with which it is associated; the other assets may encompass all other business assets including tangible personal property, tangible real estate, or other intangible assets.

.14 Economic phenomena that do not meet these specific attribute tests may not qualify as discrete intangible assets. A number of economic phenomena are merely descriptive or expository in nature. They may describe conditions that contribute to the existence and value of identified, discrete intangible assets. But these phenomena do not possess the requisite elements to distinguish themselves as discrete intangible assets.

.15 Some of the main categories of intangible assets most commonly valued are the following. See exhibit 1, "Corporate Intangible Assets," for a more detailed list.

- *Brands.* Consumer goods brands, trademarks, corporate names
- *Publishing rights.* Magazines, books, mastheads, film and music rights
- *Intellectual property.* Patents, copyrights, trademarks, and trade secrets
- *Licenses.* Television and radio, franchises, distribution rights

.16 For a typical business, descriptive economic phenomena, that do not qualify as identifiable intangible assets, may include the following:

- High market share
- High profitability
- General positive reputation
- Monopoly position
- Market potential
- Other economic phenomena

.17 Nevertheless, although these descriptive conditions do not qualify as discrete intangible assets themselves, they may indicate that the actual identifiable intangible assets do have substantial economic value. For example, they may indicate the existence of and greatly contribute to the value of loyal and profitable customer relationships.

EXHIBIT 1

CORPORATE INTANGIBLE ASSETS

These are identifiable and transferable, have a determinate life, and may not be subject to the day-to-day work efforts of the owner

• Airport gates and slots • Bank customers, including deposits, loans, trusts, and credit cards • Blueprints • Book libraries • Brand names • Broadcast licenses • Buy–sell agreements • Certificates of need • Chemical formulas • Computer software • Computerized databases • Contracts • Cooperative agreements • Copyrights • Credit information files • Customer contracts • Customer and client lists • Customer relationships • Designs and drawings • Development rights • Distribution networks • Distribution rights • Drilling rights • Easements	• Franchise agreements • Historical documents • HMO enrollment lists • Insurance expirations • Insurance in force • Joint ventures • Know-how • Laboratory notebooks • Landing rights • Leasehold interests • Literary works • Loan portfolios • Location value • Management contracts • Manual databases • Manuscripts • Medical charts and records • Mineral rights • Musical compositions • Natural resources • Newspaper morgue files • Noncompete covenants • Options, warrants, grants, and rights • Patent applications	• Product designs • Property use rights • Proposals outstanding • Proprietary computer software • Proprietary processes • Proprietary products • Proprietary technology • Publications • Retail shelf space • Royalty agreements • Schematics and diagrams • Securities portfolios • Security interests • Shareholder agreements • Solicitation rights • Stock and bond instruments • Subscription lists • Supplier contracts • Technical and specialty libraries • Technical documentation • Technology sharing agreements • Title plants • Trade secrets

• Employment contracts • Engineering drawings • Environmental rights • FCC licenses • Favorable financing • Favorable leases • Film libraries • Food flavorings and recipes	• Patents (both product and process) • Patterns • Permits • Prescription drug files • Prizes and awards • Procedural manuals • Production backlogs	• Trained and assembled workforce • Trademarks and trade names • Training manuals • Use rights (air, water, and land)

.18 For purposes of this practice aid, it is important to distinguish between intellectual property and intangible assets. Intellectual property are assets that have developed through the utilization of the mind and may be registered with a legal body, namely, the United States Patent and Trademark Office (USPTO) within the Department of Commerce or constitute trade secrets and are thus covered under Section 35(a) of the Lanham Act. As an exception, simple notice of trademarks can suffice to serve as official registration of their existence. In many developing countries, the mechanisms to ensure the protection of intellectual property are limited. With respect to intangible assets, there is no clear or generic definition.

> *Black's Law Dictionary*[2] defines an intangible asset as:
>
> Such values as accrue to a going business as goodwill, trademarks, copyrights, franchises, or the like. A non-physical, noncurrent asset which exists only in connection with something else, as the goodwill of a business.

.19 The definition that appears in the *Dictionary of Finance and Investment Terms*[3] is the following:

> The right or nonphysical resource that is presumed to represent an advantage to the firm's position in the market-place. Such assets include copyrights, patents, trademarks, goodwill, computer programs, capitalized advertising costs, organizational costs, licenses, leases, franchises, exploration permits and import and export permits.

.20 The *Accountants' Handbook*[4] defines intangible assets as "economic resources having no physical presence."

.21 The preceding definitions represent a legal, financial, and accounting interpretation of an intangible asset. The common thread in all three definitions is that an intangible asset is a resource to a corporation that enhances its position economically either by use or through the legal exploitation by others.

.22 Considering the aforementioned definitions, it would appear that there is no clear distinction between an intangible asset and intellectual property. However, if we refer back to our definition

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[2] *Black's Law Dictionary.* St. Paul, MN: West Publishing Company, 1979, 5th Edition.

[3] *Dictionary of Finance and Investment Terms.* New York: Barron Educational Services, Inc., 1985.

[4] Lee J. Seidler. *Accountants' Handbook.* New York: John Wiley & Sons, Inc., (6th Ed., 1981).

for intellectual property, we can identify those intangible assets that are considered intellectual property. Thus, intellectual property is a subset of intangible assets. For the purposes of this practice aid, intellectual property refers to patents, mask chip protection, trademarks, copyrights, trade secrets, and proprietary technology.

2. OVERVIEW OF TRADITIONAL FORMS OF INTELLECTUAL PROPERTY[5]

.01 One of the premises of the intellectual property laws is to foster innovation by affording innovators certain rights in connection with their innovations. The United States Constitution specifically authorizes Congress to enact the Patent and Copyright laws. In Article I, Section 8, Clause 8[6], the Constitution states:

> The Congress shall have power . . . to promote the Progress of Science and Useful Arts, by securing for limited times to Authors and Inventors the exclusive right to their respective writings and discoveries.

.02 The federal trademark laws have their authorization more generally in the Constitution, pursuant to Article I, Section 8, Clause 3[7], which states the following:

> The Congress shall have power . . . to regulate commerce with foreign nations, and among the several states, and with Indian tribes.

.03 The following is a general overview of the patent, trademark, and copyright systems in the United States. Following a brief overview, each section provides a basic explanation of the nature of the rights, property considerations, the registration process, and aspects of enforcement of such rights. A brief summary discussion of trade secret law is also included at the end of this overview. The growing field of intellectual property cannot possibly be covered in depth in this practice aid. The following is being presented for information purposes. CPAs should always consult with an attorney and not be in the position of making legal determinations.

3. PATENTS

Overview

.01 Patents protect inventions and discoveries.[8] In order to qualify for patent protection, inventions and discoveries must be a "new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof."[9] Since the patent system originated in the late eighteenth century, over 5.6 million United States patents have been issued.

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[5] Contributed by Eric M. Dobrusin, a patent attorney and a member of the Intellectual Property law firm of Rader, Fishman & Grauer PLLC with offices in Bloomfield Hills, Michigan, Grand Rapids, Michigan and Washington, D.C. Mr. Dobrusin authored *Intellectual Property Litigation: Pretrial Practice Guide*, (New York: John Wiley & Sons, 1996. Supplemented annually). Portions of this contribution are adapted from that title with permission from John Wiley & Sons. Special thanks to Rader, Fishman & Grauer PLLC and Celeste Burman of the Great Lakes Patent & Trademark Center (Detroit, Michigan) for their support. © 1997, Rader, Fishman & Grauer PLLC.

[6] U.S. Const. art. I, §8, cl. 8.

[7] U.S. Const. art. I, §8, cl. 3.

[8] 35 U.S.C.S. §100(a), (1952).

[9] 35 U.S.C.S. §101, (1952).

In addition to patents for utilitarian inventions, patents are available for certain ornamental designs (*design patents*), and certain plants.

.02 The USPTO is responsible for issuing patents. The United States patent system is open to residents of most foreign countries. In 1996, of the total of 116,875 patents issued, 50,159 patents were issued to residents of foreign countries.[10] Of those, table 1 lists a select breakdown by country.

Table 1
1996 U.S. Patents to Residents of Select Foreign Countries*

Country	Number of Patents
Brazil	65
Canada	2,444
China (mainland)	51
France	2,972
Germany	6,898
Israel	475
Italy	1,338
Japan	22,979
Republic of Korea	1,428
Mexico	45
Russian Federation	111
Switzerland	1,141
Taiwan	2,300
United Kingdom	2,668

* *Managing Change for Global Challenges: A Patent and Trademark Office Review—Fiscal Year 1996,* pages 109, 110.

.03 Within the United States, of the 66,716 United States patents issued to residents of the United States in 1996, the ten largest states by patents are as set forth in table 2, "1996 U.S. Patents to U.S. Residents."

[10] *Managing Change for Global Challenges: A Patent and Trademark Office Review—Fiscal Year 1996.* Wash. D.C.: United States Patent and Trademark Office, 1997, pages 100, 109, 110.

Table 2
1996 U.S. Patents to U.S. Residents*

State	Number of Patents
California	11,293
Florida	2,458
Illinois	3,643
Massachusetts	2,580
Michigan	3,271
New Jersey	3,217
New York	5,501
Ohio	3,061
Pennsylvania	3,120
Texas	4,348

* *Managing Change For Global Challenges: A Patent and Trademark Office Review—Fiscal Year 1996, page 108.*

.04 Until recently, the term of a patent generally was seventeen years from the date of issuance. In general, now the term might be up to twenty years from the date of filing of a patent application.[11]

Nature of Patent Rights

.05 The essence of patent rights resides generally in the ability to exclude others from making, using, selling, offering to sell, or importing into the United States the patented invention.[12] This "right to exclude others" must be distinguished from the right of a patent owner to make, use, sell, offer to sell, or import the patented invention. A patent confers no such right upon the patent owner.

Example A

Company ABC obtains a patent on a cocktail table having four legs and a transparent tabletop. About two years before Company ABC obtains its patent, Company XYZ obtained a patent covering the more general concept of a cocktail table having four legs and a tabletop, without regard to transparency. Assuming Company XYZ's patent is valid and enforceable (invalid or unenforceable patents cannot support a claim for infringement), Company XYZ theoretically should be able to assert its patent to exclude Company A from making, using, selling, offering to sell, or importing a cocktail table having four legs and a transparent tabletop. Company XYZ has a broader patent and can exercise its right to exclude others. Despite its patent, Company ABC does not acquire any right to commercialize its invention, because patents confer rights to exclude others and not to commercialize. Company ABC, however, might be able to exercise its right to exclude others (even if Company ABC does not

[11] See 35 U.S.C. §§ 154–156.
[12] 35 U.S.C. §§ 154; 271.

commercialize its table) and prevent Company XYZ from making, using, selling, offering to sell, or importing a cocktail table with a transparent top.

Patents as Property

.06 The Patent Act treats patents as personal property.[13] As such, patent rights can be sold pursuant to a written agreement or licensed in a like manner.[14] Licensing is a process by which a holder of patent rights, the *licensor,* grants permission to another, the *licensee*, to exploit the patented invention, usually in return for some form of payment, or *royalty.* Licenses might be *exclusive* or *nonexclusive*. An exclusive license generally means that the licensor grants rights to exploit under a patent sold to another, to the exclusion of others including the licensor. In contrast, a nonexclusive license is a grant of less than all of the exclusive rights under a patent.[15]

Example B

An individual inventor invents a new drug, but the inventor lacks the resources to make the drug, obtain regulatory approval, and sell it. The inventor might grant an exclusive license to a drug company in exchange for a royalty. The drug company would then have permission to use the patent invention to exploit the drug to the exclusion of others, including the inventor and other drug companies. If the inventor in this example granted a nonexclusive license instead, the inventor might reserve for himself or herself certain rights, for instance, the right to make and sell the patented drug, or the right to grant licenses to other drug companies.

The Patent and Application Process

.07 To be entitled to a utility patent, an inventor must demonstrate that his or her invention is all the following:

1. Useful[16]
2. New[17]
3. Nonobvious[18]

This is done by submitting to the USPTO, in addition to a government fee and certain formal papers, a written patent application that describes the invention in what is referred to as *the specification, the claims*, and any necessary drawings.[19] A patent can be based on an idea of an inventor even though the inventor has not physically built or tested the idea to see whether it works.

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[13] 35 U.S.C. § 261.

[14] *Ibid.*

[15] See generally, *Waterman v. Mackenzie*, 138 U.S. 252, 11 S.Ct. 334 (1891).

[16] 35 U.S.C. § 101; See generally *Bonito Boats, Inc. v. Thunder Craft Boats, Inc*, 489 U.S. 141, 148, 9 U.S.P.Q.2d 1847, 1851 (1989); see also *Arrhythmia Research Technology, Inc. v. Corazonix Corp*, 958 F.2d 1053, 22 U.S.P.Q. 2d (BNA) 1033 (Fed. Cir. 1992).

[17] 35 U.S.C. § 102; See generally, *Minnesota Mining & Mfg. Co. v. Johnson & Johnson Orthopeadics, Inc*, 976 F.2d 1559, 24 U.S.P.Q. 2d (BNA) 1321 (Fed. Cir. 1992); *Paragon Podiatry Lab, Inc. v. KLM Labs, Inc*, 984 F.2d 1182, 25 U.S.P.Q. 2d (Fed. Cir. 1993).

[18] 35 U.S.C. § 103; See *Graham v. John Deere Co.*, 383 U.S. 1, 148 U.S.P.Q. (BNA 459 (1966) as to design patents, *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 148, 9 U.S.P.Q.2d 1847, 1851 (1989); see also *Avia Group Int'l, Inc. v. L.A. Gear Cal., Inc*, 853 F.2d 1557, 7 U.S.P.Q. 2d (BNA) 1548 (Fed. Cir. 1988) (regarding nonfunctionality requirement).

[19] 35 U.S.C. §§ 111, 112 and 113.

.08 Section 112 of the Patent Act states that "the specification shall conclude with one or more claims particularly pointing out and distinctly claiming the subject matter that the applicant regards as his invention."[20] The *claims* of a patent (which are the numbered paragraphs found at the end of a patent, usually preceded by the phrase "I (we) claim:" or "What is claimed is:") define the *metes and bounds* of the patent right, as a deed stakes out the metes and bounds of real estate.[21]

Example C

One way that Company ABC from Example A might seek to claim its tabletop is as follows.

What is claimed is—

1. A table, comprising—
   a. A base portion having at least four legs.
   b. A transparent planar surface disposed on said base portion.

Another way Company ABC might seek more narrowly to claim its table is as follows.

What is claimed is—

2. A cocktail table, comprising—
   a. A base having four legs that are generally vertically oriented in relation to a floor surface.
   b. A rectangular glass tabletop disposed on said base.

As can be seen, the "scope" of claim coverage can vary depending upon the words used to describe the invention. One claim literally might cover some tables, while another does not. For example, claim 1 might cover a table having legs that are at an angle and not vertical or has a triangular tabletop, while claim 2 would not literally cover such a table.

.09 After it receives a patent application, the USPTO, which maintains the confidentiality of pending patent applications under 35 U.S.C. §122, assigns the task of examining the application to a patent examiner, an individual who generally has expertise or training in the technical field to which the invention pertains.[22] The examiner has the responsibility of reviewing the patent application to determine whether the inventor meets the requirements for a patent. In addition to reviewing the application for indications of utility and for form, the examiner ordinarily will conduct a search for patents or other published literature (referred to as *prior art*) that preceded the patent application to see whether the claimed invention is new and nonobvious in view of the

[20] 35 U.S.C. §112.

[21] *Corning Glass Works v. Sumitomo Elec. U.S.A*, 868 F.2d 1251, 1257, 9 U.S.P.Q.2d (BNA) 1962, 1966–1967 (Fed. Cir. 1989).

[22] See 35 U.S.C. §131.

prior art. The average time allocated to this initial examination process for 1996 was about 10.5 months from the date the application was filed.[23]

.10 In a bulk of instances, an examiner will reject a patent application after the initial examination in the belief that the requirements for patentability have not been met.[24] To illustrate the frequency of this occurrence, as of September 30, 1996, the USPTO had 379,064 patent applications pending in various stages, of which 273,792 were in the process of examination, with 116,106 of those yet to be examined. Of the remaining 157,686, examiners had rejected at least 116,037 applications.[25]

.11 Nevertheless, the rejection of an application does not prohibit an applicant from further pursuing a patent. The applicant has various options for responding to the rejection, such as arguing with the examiner, amending the application (for example, changing the words of the claim so the claim covers patentable subject matter), or appealing the examiner's decision.[26]

.12 A number of applicants do not succeed in obtaining a patent and eventually abandon their applications. On the other hand, an applicant who succeeds in persuading the Examiner that the requirements for patentability have been met will have the application allowed by the USPTO. After payment of a government fee, the applicant is entitled to have his or her allowed patent application *issued* by the USPTO as a United States Patent. Once issued, a patent is presumed to be valid.[27]

.13 As can be appreciated, the large volume of patent applications combined with the labor-intensive efforts of examination and correspondence between the USPTO and applicants or their attorneys or agents frequently results in a substantial period of time during which the application is pending before the USPTO. For 1996, the average pendency time for the average patent application, from filing until issuance, was about 20.8 months.[28]

Enforcement of Patent Rights

.14 Unless and until a patent issues, even if an item has the marking *patent applied for* or *patent pending*, an inventor (or his or her assigns) possesses no federal statutory right to exclude others from exploiting the invention under the Patent Act.[29] If any protection exists, it is generally under any applicable state law governing contracts, trade secrets, or unfair competition, or under the Copyright or Lanham Acts (the federal trademark and unfair competition laws), if applicable.

.15 Once a patent issues, however, the patent confers the various rights to exclude others, as discussed previously. Relative to unauthorized exploiters of the patented invention, the matter then becomes one of enforcement.[30] Remedies for patent infringement may be pursued by a civil

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[23] *Managing Change For Global Challenges: A Patent And Trademark Office Review—Fiscal Year 1996,* page 92.

[24] 35 U.S.C. §132.

[25] *Managing Change For Global Challenges: A Patent And Trademark Office Review—Fiscal Year 1996,* page 101.

[26] 35 U.S.C. §§ 132, 134 and 141 et. seq.

[27] 35 U.S.C. §282.

[28] *Managing Change For Global Challenges: A Patent And Trademark Office Review—Fiscal Year 1996,* page 100.

[29] See generally *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 9 U.S.P.Q.2d 1847 (1989); see 35 U.S.C. § 287 (patent marking).

[30] 35 U.S.C. § 271(a) states: "Except as otherwise provided in this title, whoever without authority makes, uses, offers to sell or sells any patented invention, within the United States or imports into the United States any patented invention during the term of the patent therefore, infringes the patent."

action for infringement, which must be brought in a United States federal court.[31] Appeals of patent cases can be taken to a special court of appeals called the Court of Appeals for the Federal Circuit.

.16 Even though many United States patents include more than one claim (recall from the preceding discussion, the claim verbally describes the invention just as a deed describes a parcel of real estate), liability for patent infringement may exist for infringement of but a single patent claim.[32] As stated in *Southwall Technologies, Inc. v. Cardinal IG Co.*, the test for infringement of a United States utility patent involves the following two steps:

> First, the asserted claims must be interpreted by the court as a matter of law to determine their meaning and scope. In the second step, the trier of fact determines whether the claims as thus construed read on the accused product to establish literal infringement, every limitation set forth in a claim must be found in an accused product exactly.[33]

.17 If an accused product (or process) is covered by each limitation of the claim verbatim, then there can be *literal infringement*. If all limitations in a claim do not find correspondence in an accused product, the inquiry does not end. The U.S. Supreme Court has indicated that an infringer should not escape liability for insubstantial changes relative to a patented invention. The Court has adopted the *doctrine of equivalents*, which examines each element of the claim of a patent and examines the accused product (or process) to assess effectively whether the alleged differences are substantial.[34] Courts have applied different approaches to the analysis. Under *Graver Tank & Mfg. v. Linde Air Products Co.*, as illustrated in Example D, the Supreme Court advanced an approach addressing whether the accused subject matter performs substantially the same function in substantially the same way to achieve the same result as the claimed invention.[35] Other factors considered included evidence of interchangeability, copying, designing around, or an independent development.[36] A number of cases have considered whether an accused infringer obtained a patent for the accused subject matter.[37]

> Example D
>
> Suppose in the prior Examples A and C, Company ABC asserts its patents against Company MNO, which makes a table that has a transparent tabletop, and a three-legged base. Because the table does not have four legs, there is no literal infringement. However, the inquiry will focus on whether the three-legged base is an equivalent to the claimed four-legged base. One way to address that issue might be to analyze whether the three-legged base performs substantially the same function as the four-legged base recited in the claim and whether it

[31] 35 U.S.C. § 281; 28 U.S.C. § 1338(a); see also, *Christianson v. Colt Industries Operating Corp*, 486 U.S. 800, 807-808 (1988).

[32] *Pall Corp. v. Micron Separations, Inc*, 66 F.3d 1211, 1220, 36 U.S.P.Q.2d (BNA) 1225, 1231 (Fed. Cir. 1995).

[33] 54 F.3d 1570, 1575, 34 U.S.P.Q.2d (BNA) 1673, 1676 (Fed. Cir. 1995)(citations omitted); see also *Markman v. Westview Instruments, Inc.*, 517 U.S. 370, 38 U.S.P.Q.2d (BNA) 1461 (1996); cf. *Gorham v. White*, 81 U.S. (14 Wall.) 511, 20 6Ed. 731 (1871) (regarding test for design patent infringement).

[34] See generally *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.*,____ U.S. ___, 41 U.S.P.Q.2d (BNA) 1865, 1876 (1997).

[35] 339 U.S. 605, 608 (1950).

[36] *Hilton Davis Chem. Co. v. Warner-Jenkinson Co.*,62 F.3d 1512, 1519, 35 U.S.P.Q.2d (BNA) 1641, 1646 (Fed. Cir. 1995)(en banc), rev'd, ___ U.S. ___, 41 U.S.P.Q.2d (BNA) 1865 (1997).

[37] See, e.g., *Zygo Corp. v. Wyko Corp.*, 79 F.3d 1563, 38 U.S.P.Q.2d (BNA) 1281 (Fed. Cir. 1996).

does so in substantially the same way to achieve the same result as the four-legged base.

.18 The courts have imposed some restrictions on the possible available equivalents, by way of the doctrine of prosecution history estoppel or based on whether the patentee (meaning, the patent owner) is attempting to cover subject matter that exists in the prior art.[38] These tend to be complicated legal doctrines. Example E provides a simplified example.

Example E

Even if Company ABC could establish the three-legged base as equivalent to the recited four-legged base, the patent owner should not prevail if, for instance, the patent owner amended the claim while pending before the USPTO for purposes of patentability over a prior art table having three legs and a transparent tabletop. In other words, as a condition for being able to obtain the patent, the patent owner had to change its claims to cover a four-legged base table from something less limiting, thereby distinguishing the prior art patent. Likewise, such a prior art table demonstrates that the accused table may have been in the public domain. A patent owner should not be able to use the doctrine of equivalents to cover a product that the public had a right to copy because it was in the public domain.

.19 Assuming a patent owner prevails in proving infringement, the accused infringer is still entitled to assert defenses, such as those attacking the validity or enforceability of the patent.[39] Because patents are presumed to be valid when issued, the person challenging the validity or enforceability of the patent will generally need to prove that the USPTO should not have issued the patent, or that the patent owner should not be allowed to enforce the patent because the patent owner violated some duty in obtaining or maintaining the patent.

.20 A patentee who proves infringement and overcomes the defenses asserted so as to establish liability for infringement is entitled to appropriate remedies under the Patent Act. Available remedies under the Patent Act include injunctions, by a court order that certain activities cannot occur.[40] Money damages may also be awarded (calculation of damages is discussed at the end of the practice aid).[41] Attorney fees and interest are also possible.[42] In some instances of infringement, a court might treble the actual damages award such as when the infringement is willful.[43]

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[38] See *Warner-Jenkinson Co. v. Hilton Davis Chem. Co.,* ____ U.S. ___, 41 U.S.P.Q.2d (BNA) 1865, 1876 (1997)(re doctrine of prosecution history estoppel); *Wilson Sporting Goods Co. v. David Geoffrey & Assocs.,* 904 F.2d 677, 684, 14 U.S.P.Q.2d (BNA) 1942, 1948 (Fed. Cir.), cert. denied, 498 U.S. 992 (1990).

[39] See generally Eric M. Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide.* New York: John Wiley & Sons, 1996 and supplemented in 1997. §2.14 and listing many of the available defenses.

[40] 35 U.S.C. §283.

[41] See generally, Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide,* §2.22-2.31.

[42] 35 U.S.C. §§ 284 and 285.

[43] 35 U.S.C. § 284; see also, *Underwater Devices, Inc. v. Morrison-Knudsen Co.,* 717 F.2d 1380, 219 U.S.P.Q. (BNA) 569 (Fed. Cir. 1983) (addressing "duty to seek and obtain competent legal advice from counsel before the initiation of any possible infringing activity").

4. TRADEMARKS

Overview

.01 Trademarks (*service marks,* in the case of services) serve to identify and distinguish the goods or services of one person from the goods or services of another, "and to indicate the source of the goods (or services), even if that source is unknown."[44] Any of a number of symbols or designations can serve as a trademark, such as words, logos, product configurations, and sounds. A color might also be entitled to trademark protection.[45] One way to see whether a person claims to own a trademark is to look for the designations *TM, SM* (for services marks), or *®* (for registered marks).

.02 In contrast to patents and copyrights, trademarks may be afforded protection both under federal laws (whether federally registered or not) or state law. Among other purposes, the trademark laws are intended to prevent "the deceptive and misleading use of marks" in commerce, and "to protect persons engaged in such commerce against unfair competition."[46] Additionally, certain trademark laws can be used to exclude others from "lessening the capacity of a famous mark to identify and distinguish goods or services" regardless of whether there is an absence of competition or likelihood of confusion.[47]

Nature of Trademark Rights

.03 Trademark rights arise by virtue of use. In general, the first to use a symbol as a mark to distinguish goods or services is entitled to exclude others from making a confusingly similar use of the mark. The failure to continue to use a mark appropriately could result in an *abandonment* of the mark, meaning, a forfeiture of trademark rights.[48]

Trademarks as Property

.04 Trademark rights can be sold along with the goodwill of the business associated with the mark. They also can be licensed, provided that certain requirements are imposed under the licensee to help preserve the "source indicating" nature of the mark.[49]

Registration Process

.05 Trademark rights and entitlement to relief for infringement, under federal laws, is possible both with and without a federal trademark registration. In the absence of a registration, relief requires proof that the mark has acquired secondary meaning or is inherently distinctive.[50]

.06 The USPTO awards federal trademark registrations assuming an application to register is filed, with an appropriate fee and specimens showing how the mark is used, and certain

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[44] See 15 U.S.C. § 1127 (defining *trademark* and *service mark*; both are referred to as *mark* or *trademark* herein for convenience).

[45] See *Qualitex Co. v. Jacobson Prods,* __U.S. __, 115 S. Ct. 1300, 34 U.S.P.Q. 2d (BNA) 1161 (1995).

[46] 15 U.S.C. §1127.

[47] 15 U.S.C. §1127.

[48] See generally 15 U.S.C. §§ 1115(b)(2) and 1127; *Roula v. Russ Berrie & Co.* 886 F.2d 931 (1989), 12 U.S.P.Q. 2d (BNA) 1423, 1428 (7th Cir. 1989), cert. denied, 493 U.S. 1075 (1990).

[49] See generally *Stanfield v. Osborne Industries, Inc.* 52 F.3d 867, 871-72, 34 U.S.P.Q.2d (BNA) 1081 (1992).

[50] See 15 U.S.C. § 1125(a), *Two Pesos, Inc. v. Taco Cabana, Inc.* 505 U.S. 763, 23 U.S.P.Q. 2d (BNA) 1081 (1992).

requirements are met.[51] The current registration process also allows a person to pursue a registration based simply on a "bona fide intent to use" a mark in commerce.[52] This will afford an applicant who does not actually use a mark but wants to preserve it for the future with certain potential priority rights.

Example F

Company ABC owned a trademark on the word mark RUFF for television sets. Company ABC stopped using RUFF in 1991. In 1995, Company XYZ decides it wants to sell television sets that were being developed at the time, but were not yet available for sale, under the mark RUFF. Because it has not used its mark in commerce yet, Company XYZ files an intent-to-use application to register RUFF. Company XYZ might be able to register RUFF if it can be established that Company ABC abandoned its RUFF mark, and therefore, gave up its prior rights in the mark relative to Company XYZ.

.07 In a process similar to the application process employed by the USPTO to examine patent applications, the USPTO also examines applications to register trademarks. After filing, the application is assigned to a trademark attorney, an attorney employed by the USPTO who has the task of evaluating whether the requirements for registering a mark have been met.

.08 In addition to examining the registration for specifically enumerated categories of unregistrable marks (for example, immoral, deceptive, scandalous, or merely descriptive), the trademark attorney will conduct a search of registered marks to determine whether prior registered marks exist that are likely "to cause confusion, or to cause mistake, or to deceive relative to the mark sought to be registered."[53]

.09 Upon examination, the trademark attorney will either reject the application or allow the application to register. The applicant is afforded an opportunity to challenge the rejections. If the application is allowed, the public is notified in a government publication called the *Official Gazette*, so that members of the public can object to the grant of a registration in what is called an *opposition* proceeding. Assuming the mark is not opposed successfully, a registration will issue.

.10 Among other purposes, the registration can be used in a lawsuit as "evidence of the validity of the registered mark and of the registrant's exclusive right to use the registered mark in commerce."[54] Provided certain conditions are met, after a prescribed period of time, a registered mark might become "incontestable" and, therefore, not subject to an attack of its validity except for and only for particular reasons.[55]

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[51] 15 U.S.C. §1051.
[52] 15 U.S.C. §1051(b).
[53] 15 U.S.C. §1052.
[54] 15 U.S.C. §1115(a).
[55] 15 U.S.C. §1115(b).

.11 To put the registration system in perspective, as of September 30, 1996, the USPTO reports the following.

1. There exist 784,667 active certificates of registration.
2. In 1996, the USPTO issued 78,674 certificates of registration.
3. As of September 30, 1996, there were 271,754 pending trademark applications.
4. Excluding intent-to-use applications, the average pendency time of trademark applications (from filing to issuance) during 1996 was about 16.5 months.[56]

Enforcement of Trademark Rights

.12 Whether a trademark owner sues for infringement under a trademark registration or not, the test for infringement ordinarily involves an analysis of "likelihood of confusion." That is, the infringement may lie if an accused mark is "likely" to cause confusion as to "origin, sponsorship or approval" of the goods or services in question.[57]

.13 Likelihood of confusion is a test that varies from region to region across the United States.[58] To illustrate, one test that has been employed in the federal regional circuit covering Michigan, Ohio, Kentucky, and Tennessee looks at the following factors:

1. Strength of mark
2. Relatedness of services (or goods)
3. Similarity of marks
4. Actual confusion
5. Marketing channels
6. Likely degree of purchase care
7. Defendant's intent in selecting the mark
8. Likelihood of expansion of product lines[59]

.14 As mentioned previously, a trademark owner who pursues relief in a federal suit, without owning a federal trademark registration, will need to prove that the mark is inherently distinctive or that it has acquired distinctiveness. The latter is referred to as having acquired *secondary meaning,* which generally means that a mark has been used to such an extent that it has come to be recognized by consumers as being associated with a particular source.[60]

.15 A suit for trademark dilution may be possible under federal or state law in many states. Dilution lawsuits often occur between two parties that do not necessarily compete with each other, and there may be no likelihood of confusion. Nevertheless, because of the manner in which the accused party is using a strong mark, the accused party either is disparaging the mark or otherwise is diminishing the value of the trademark to serve as a source indicator. Dilution actions have become more popular recently in view of disputes over Internet domain names.[61] In

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[56] *Managing Change for Global Challenges—A Patent and Trademark Office Review,* 1996, pages 112–113.

[57] 15 U.S.C. § 1114 authorizes actions for infringement of a federal trademark; 15 U.S.C. § 1125(a) authorizes actions for infringement of unregistered marks or "false designations of origin" or the like.

[58] See generally Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide,*§3.26.

[59] See, for example, *Champions Golf Club, Inc. v. The Champions Golf Club, Inc.,*78 F.3d 1111, 38 U.S.P.Q.2d 1161 (6th Cir. 1996); cf. Cases cited in Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide,*§3.26.

[60] See generally *Two Pesos, Inc. v. Taco Cabana, Inc.,*505 U.S. 763, 755 n.4, 23 U.S.P.Q.2d (BNA) 1081, 1082 n.4 (1992) (citation omitted).

[61] See, for example, *Toys "R" Us, Inc. v. Akkaowi,* 40 U.S.P.Q.2d (BNA) 1836 (N.D. Cal. 1996); *Intermatic, Inc. v. Toeppen,* 40 U.S.P.Q.2d (BNA) 1412 (N.D. Ill. 1996).

addition to any available state law remedies, remedies for dilution are authorized in like manner as remedies under the Lanham Act for registered trademark infringement (15 U.S.C. §1114) or unfair competition (15 U.S.C. §1125(a)).

Example G

Company ABC has used the mark BORAX for facial tissue for over fifty years. Company XYZ adopts the name BORAX for its Internet domain name. Company XYZ offers adult entertainment at the Web site. Even though it might be argued that Company ABC and Company XYZ do not compete or offer related goods or services, Company ABC might pursue a lawsuit for dilution, because of the belief of potential detraction in the value of the name BORAX because of its association with adult entertainment. If Company XYZ also offers tissue-related products at its Web site, and a potentially competitive situation is established, Company ABC might also be able to pursue an action for infringement.

.16 An accused infringer has a host of potential defenses that might be raised in response to a charge of infringement, apart from a non-infringement defense. Examples include that a mark has become generic; a registered mark was obtained fraudulently; the mark has been abandoned; prior use.[62]

.17 Assuming a trademark owner prevails in establishing liability for infringement, the trademark owner has various possible remedies authorized by law. Injunctions are possible to prevent or restrict further use of infringing mark.[63] The trademark owner might be able to obtain an order requiring materials bearing the accused mark to be destroyed.[64] Money damages awards are also possible,[65] as are awards for costs and attorney's fees.[66]

5. COPYRIGHTS

Overview

.01 Copyrights protect "original works of authorship fixed in any tangible medium expression . . .".[67] Subject to certain restrictions, under 17 U.S.C. §102, works of authorship include the following categories:[68]

1. Literary works
2. Musical works, including any accompanying words
3. Dramatic works, including any accompanying music
4. Pantomines and choreographic works
5. Pictorial, graphic, and sculptural works
6. Motion pictures and other audiovisual works

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[62] See generally 15 U.S.C. § 1115; see also, Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide*,§3.28.

[63] 15 U.S.C. §1116.

[64] 15 U.S.C. §1118.

[65] 15 U.S.C. §1117.

[66] *Ibid.*

[67] 17 U.S.C. §102.

[68] *Ibid.*

7. Sound recordings
8. Architectural works

The Copyright Act also affords certain protections for semiconductor chip product mask works.[69] One way to identify whether someone claims a copyright in a particular work is to look for a *copyright notice,* the familiar ©, usually followed by a year and a name.[70] The substitution or additional use of a circle with a letter *P* inside for or with © indicates a claim of copyright in a published sound recording.[71]

Nature of Exclusive Rights

.02 Subject to certain limitations, Section 106 of the Copyright Act enumerates the following six categories of exclusive rights conferred upon copyright owners:

1. To reproduce the copyrighted work in copies or phonorecords
2. To prepare derivative works based upon the copyrighted work
3. To distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending
4. In the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly
5. In the case of literary, musical, dramatic and choreographic works, pantomimes, and pictorial, graphic or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly
6. In the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission[72]

Example H

Suppose an author writes a novel and copyrights the work. If a company wanted to make an abridged audio cassette version of the novel, the author should have the exclusive rights to reproduce all or certain parts of the work, or to prepare a derivative work, for example, the sound recording mentioned in item 1 of the preceding list, and abridgment of the work, mentioned in item 2 of the preceding list.[73] It is theoretically within the scope of the copyright laws that the author would be entitled to protect copying of the work even if it is not reproduced in the same medium nor if only a partial amount of the material is copied. To avoid the potential for liability, the company could seek a license under the copyright.

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[69] See generally 17 U.S.C. §901 et seq.

[70] 17 U.S.C. §401.

[71] 17 U.S.C. §402.

[72] 17 U.S.C. §106.

[73] 17 U.S.C. §101 defines a *derivative work* as follows:
A derivative work is a work based upon one or more preexisting works, such as a translation, musical arrangement, dramatization, fictionalization, motion picture version, sound recording, art reproduction, abridgment, condensation, or any other form in which a work may be recast, transformed, or adapted. A work consisting of editorial revisions, annotations, elaborations, or other modifications which, as a whole, represent an original work of authorship, is a derivative work.

.03 The rights granted by a copyright are not the rights to exclude all kinds of copying. For instance, copying might be permissible to the extent that the subject matter copied is not "fixed in a tangible medium," or the portion copied does not satisfy the originality requirement.[74] The Copyright Act does not afford protection "to any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work."[75] Moreover, among the limitations on the copyright owner's exclusive rights is the doctrine of *fair use* as set forth in 17 U.S.C. §107.[76] Under that doctrine, copying for certain "purposes such as criticism, comment, news reporting, teaching . . . scholarship, or research" might not constitute infringement, depending upon such factors as the following:

1. The purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes
2. The nature of the copyrighted work
3. The amount and substantiality of the portion used in relation to the copyrighted work as a whole
4. The effect of the use upon the potential market for or value of the copyrighted work

Example I

Suppose a clergy member made copies of one chapter of the book from the Example H, preceding, and circulated the copies to members of a congregation during a holiday service. The clergy member then referred to the article during a sermon. The clergy member might be able to argue successfully that the copying constitutes a fair use because, for instance, only part of the work is copied, the copies were made for purposes of comment, and the use is not commercial and may even have the effect of generating sales of the book to benefit the author.

Copyrights as Property

.04 Like initial ownership of patent rights vests in the inventor absent an agreement, the initial title to a copyright belongs to the author of a work. Ownership of a copyrighted work sometimes is complicated by a doctrine called a "work made for hire."[77] Under that doctrine, it is possible for the author to be someone other than the person who actually performed the physical act of creating the work. The Copyright Act addresses two particular scenarios in which this might occur, namely in employer–employee situations (for example, when an employee creates a work within the scope of employment, the author is the employer); and as to certain commissioned works.[78]

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[74] See 17 U.S.C. § 102 ("copyright protection subsists . . . in original works of authorship fixed in any tangible medium of expression . . ."); see also *Feist Publications, Inc. v. Rural Tel. Serv. Co.,*499 U.S. 340, 18 U.S.P.Q.2d (BNA) 1275 (1991).

[75] 17 U.S.C §102.

[76] 17 U.S.C. §107; see also *Campbell v. Acuff & Rose Music, Inc.,* 114 S.Ct. 1164, 29 U.S.P.Q.2d (BNA) 1961 (1994); *Sony Corp. of Am. v. Universal City Studios, Inc.,* 464 U.S. 417, 220 U.S.P.Q. (BNA) 665 (1984).

[77] 17 U.S.C. §101.

[78] Id.; See also *Community for Creative Non-Violence v. Reid,*490 U.S. 730, 10 U.S.P.Q.2d (BNA) 1985 (1989).

Example J

A photography studio that takes a class photo for a student who hires the studio as an independent contractor might own the copyright of the photo in the absence of an agreement under the work made for hire doctrine. The student thus would need to obtain the right from the studio to make additional copies of the photo, even though the student purchased the photograph, because ownership of the photograph does not equate to ownership of the copyright.[79] However, the photographer who is employed by the studio as an "employee" to take the photograph may not be the author. Instead, under the Copyright Act, the studio would be the author.

.05 Notwithstanding the above, copyrights are transferable, in whole or in part, generally by written agreement.[80] Exclusive or nonexclusive licenses are also means of transferring rights under a copyright.

The Registration Process

.06 The law of copyright is exclusively federal.[81] To bring a suit for copyright infringement and obtain certain remedies for copyright infringement, though a copyright may exist automatically at the time of creation, a copyrighted work should be registered with the Copyright Office.[82]

.07 The registration process ordinarily involves the submission of an application to register, a government fee, and a deposit of one or more copies of the work.[83] The Copyright Office then examines the application to assure the subject matter is copyrightable and that "other legal and formal requirements" have been met.[84]

.08 *Originality* is a fundamental requirement for copyrightability. The Supreme Court has addressed the requirement of originality generally, and has determined that the alphabetical listing of names and addresses in a white pages telephone directory does not satisfy a minimal degree of creativity to be original.[85]

.09 Assuming the application is satisfactory (which it generally is in a large number of instances), the Copyright Office will issue a certificate of registration, effective on the date that the Copyright Office has received the necessary requirements as acceptable for registration.[86] Sometimes the Copyright Office will refuse registration, usually affording the applicant an opportunity to respond. The application process generally takes at least several months to complete. Upon registration, the certificate of registration, if within five years of the first

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[79] See also 17 U.S.C. § 202, which states in part: "ownership of a copyright . . . is distinct from ownership of any material object in which the work is embodied".

[80] 17 U.S.C. §201(d); 17 U.S.C. §204.

[81] 17 U.S.C. §301.

[82] 17 U.S.C. §§411, 412.

[83] 17 U.S.C. §§408, 409.

[84] 17 U.S.C. §410.

[85] *Feist Publications, Inc. v. Rural Tel. Serv. Co.,*499 U.S. 340, 18 U.S.P.Q.2d (BNA) 1275 (1991).

[86] 17 U.S.C. §410.

publication of the work, constitutes "prima facie evidence of validity of the copyright and of the facts stated in the certificate."[87]

.10 ***Copyright Notice.*** Notice of copyright, shown as either the symbol ©, or the words *Copyright* or *Copr.*; the year of first publication; and the name of the owner, is no longer required in order to establish copyright in a work. However, if present, it may afford certain benefits to the copyright owner, independent of the obvious deterent effect.[88]

Enforcement of Copyrights

.11 The violation of any of the exclusive rights indicated earlier can give rise to an action for copyright infringement arising under the Copyright Act.[89] Such actions are filed in the United States federal district courts.[90] Proving infringement requires proof of copying of elements of the work that are original.[91] Proof of copying can be satisfied by direct or circumstantial evidence. Under the latter approach, evidence is required to prove that the accused infringer had access to the copyrighted work (such as when the accused infringer had an opportunity to review the copyrighted work) and that the accused infringing work is substantially similar to the copyrighted work.[92]

.12 An accused infringer may have a host of defenses available including, for example, the above-mentioned fair use defense, and the defense that the accused infringer independently created the accused work.[93]

.13 A copyright owner who prevails in an action for infringement has various possible remedies available, as under the patent laws. In addition to the possibility of an injunction under 17 U.S.C. §502, the possibility exists under 17 U.S.C. §503 for impoundment and destruction of the accused subject matter. Money damages may also be possible under 17 U.S.C. §504, with the statute setting a minimum damage award for certain infringements.[94] Actual damages alternatively might be pursued, sometimes with a high degree of success.[95] Costs and attorney's fees are also possible under 17 U.S.C. §505. In some instances, copyright infringement may invite criminal prosecution.[96]

6. TRADE SECRETS

.01 The law of trade secrets is addressed summarily to note that such law is governed by the laws of the different states. However, the United States recently enacted laws making criminal

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[87] 17 U.S.C. §410(c).

[88] See generally 17 U.S.C. §§ 401–406.

[89] 17 U.S.C. §501(a).

[90] 28 U.S.C. §1338.

[91] See *Feist Publications, Inc. v. Rural Tel. Serv. Co.,*499 U.S. 340, 18 U.S. P.Q.2d 1275 (1991).

[92] See generally *Gaste v. Kaiserman,* 863 F.2d 1061, 9 U.S.P.Q.2d (BNA) 1300 (2d Cir. 1988); *Shaw v. Lindheim,* 919 F.2d 1353, 15 U.S.P.Q.2d (BNA) 1516 (9th Cir. 1990); *Laureyssens v. Idea Group, Inc.,*964 F.2d 131, 22 U.S.P.Q.2d 1811 (2d Cir. 1991).

[93] *Wildlife Express Corp. v. Carol Wright Sales, Inc.,* 18 F.3d 502, 30 U.S.P.Q.2d (BNA) 1140 (7th Cir. 1994) (regarding independent creation); see also, Dobrusin, *Intellectual Property Litigation: Pretrial Practice Guide,*§3.14

[94] See 17 U.S.C. § 504; *F.W. Woolworth Co. v. Contemporary Arts, Inc.,*344 U.S. 228, 95 U.S.P.Q. BNA 396, 398 (1952).

[95] See, for example, *Cream Records, Inc. v. Jos. Schiltz Brewing Co.,*864 F.2d 668 (9th Cir. 1989).

[96] See generally 17 U.S.C. §506.

certain thefts of trade secrets.[97] Trade secrets arise, among other reasons, by virtue of the nature of the subject matter in question and measures taken to preserve the secrecy of the subject matter in question. Though the definition of trade secrets may vary, courts often require proof of "secrecy" and "some minimal novelty."[98] In some states, the basic elements for a suit alleging trade secret misappropriation are the following:

1. A trade secret
2. Acquisition of the trade secret in confidence
3. The unauthorized use of the trade secret[99]

7. CIRCUMSTANCES REQUIRING THE VALUATION OF INTELLECTUAL PROPERTY

.01 The valuation of intellectual property is performed primarily for the following reasons:

1. *Allocation of purchase price.* All tangible and intangible assets of a corporation are appraised. The appraised values of the assets serve as a basis for depreciation and amortization by the acquiring company of the acquired company's tangible and intangible assets. The allocation of purchase price represents a common situation for the valuation of intangible assets.
2. *Transfer pricing.* Multinational corporations are required by §482 of the Internal Revenue Code (IRC) to deal with their affiliates at "arm's length." To comply with this law, multinational corporations set up transfer prices for products and services between related corporate entities. With respect to intellectual property and intangible assets, various sharing arrangements, including licensing agreements, are established between the related parties. Any sale of intellectual property to a related party must be at fair-market value and the related party's right to use such assets should reflect a royalty rate that is considered arm's length.
3. *Transactions.* Establish a fair and reasonable price for the intellectual property for the parties involved in the transaction.
4. *Financing.* Corporations sometimes pledge their intellectual property as collateral in order to borrow funds. Therefore, it is necessary to arrive at a valuation of those pledged assets.
5. *Corporate resource and tax planning.* Tax strategies often involve the transfer of intangible assets and intellectual property to an investment holding company. This is particularly true in states such as Delaware, where the state and local tax benefits of such a strategy can be substantial. For purposes of ascertaining returns on research and development and for the portfolio management of intellectual property, valuations are often performed to advance corporate objectives. Additionally, companies have become more aware of the need to have intellectual property identified, cataloged, and valued for resource allocation purposes. Indeed, companies need to become aware of the costs associated with developing their technology to determine the return on investment and to satisfy other corporate objectives. Central to this are the costing of resources, the understanding of markets, and the importance of the intellectual property to the corporate objectives.

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[97] 18 U.S.C. §§1831-1839 (Economic Espionage Act of 1996).

[98] See generally *Kubik, Inc. v. Hull,* 56 Mich. App. 335, 185 U.S.P.Q. (BNA) 391 (1974).

[99] See generally *Aerospace Am., Inc. v. Abatement Technologies,*738 F. Supp. 1061 (E.D. Mich. 1990).

6. *Litigation services.* Quantification of damages in different kinds of litigation. This analysis often occurs in infringement actions but also may be necessary in breach of contract, property settlements, fraud, slander, or libel matters.

Based on the preceding, the reasons for the valuation of intellectual property and intangible assets generally fall into the following four major categories: tax, transaction or financing, litigation services, and corporate planning.

8. ENGAGEMENT ADMINISTRATION

AICPA Standards

.01 The appraiser should adhere to the established appraisal standards that are currently in place when conducting their analysis, which for CPAs are the following, at the minimum:

- Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards,* vol. 2, CS sec. 100)
- *Code of Professional Conduct* (AICPA, *Professional Standards,* vol. 2, ET sec. 50–500)

In addition, the appraiser should realize that the environment in which he or she is conducting his or her work is constantly changing. This is especially true with respect to the valuation of intellectual property. As discussed earlier in this practice aid, there are a number of forums in which the appraiser can be asked to apply their expertise. One of the more common forums is the litigation environment, in which the analysis of the appraiser will many times come under intense scrutiny and attack by opposing parties. As such, in the litigation environment, the appraiser needs to be fully cognizant of the heightened responsibility and detail associated with their efforts.

The Premise of Value

.02 It is necessary that the appraiser not only understand the various premises of value, but also what premise of value the appraiser will adopt for purposes of rendering his or her opinion. Although it is common for appraisers to disagree regarding the value of a certain asset, more often than not there are disagreements as to what standard or premise of value to be utilized. The following represents some of the more common kinds of value premises and their respective definitions:

- ***Fair market value.*** This is one of the most widely recognized premises of value. The widely held definition of fair-market value is as set forth in Revenue Ruling 59-60 is as follows:

> [T]he price, in cash or other consideration, at which property would change hands between a buyer and a seller, each being informed of the facts and under no compulsion to buy or sell.

.03 The preceding definition is often considered in the same context as an arm's-length transaction and represents one of the most common standards of value. This is sometimes used by companies internally and is usually used by the Internal Revenue Service.

- *Investment value.* This is a term that was originally borrowed from real estate valuation circles and was considered to be the value to a particular investor based on that investor's individual desires and requirements. Nevertheless, there is a clear distinction between investment value and the concept of fair-market value. Differences between these two terms arise because of inherent differences between possible individual buyers and the seller. For example, buyer *A* may possess certain competitive advantages over the seller, buyer *B,* such that buyer *A* can expect higher levels of future earnings through the purchase or use of the asset in question. Further, buyer A may have other advantages, such as favored access to credit markets in which to obtain funds to purchase the asset in question. Alternatively, they may simply be much more tolerant of the risk associated with operations, thereby willing to accept higher risk for higher returns. Thus, buyer *A* may pay more for the asset than the "consensus of buyers in the marketplace" because of the strengths of buyer *A*.
- *Intrinsic or fundamental value.* This relates to the value of the underlying asset or assets without the influences inherent in the definition of investment value. For example, the intrinsic value could contain an assessment of the value of an asset or assets, the value of potential future earnings, as well as some assessment of growth of those earnings. As the definition of intrinsic value can lead to the utilization of subjective criteria, the appraiser must utilize his or her professional judgment to develop these estimates.
- *Liquidation value.* This assumes that the business or asset to be valued will be liquidated. As such, there is a likelihood that the price obtained during liquidation may be lower than what could be otherwise obtained. This is attributable to a variety of factors. For example, buyers may realize that the seller has a strong motivation to divest itself of the asset in question and therefore may offer a reduced price to the seller, in recognition of the seller's circumstances. There may also be additional costs to be considered in liquidation that will affect the ultimate amount received for the asset.
- *Book Value.* This is widely considered an accounting concept as it is nothing more than the excess (or deficit) of assets over liabilities. As such, it incorporates costs such as depreciation and amortization, which provide avenues for companies to realize tax benefits associated with certain assets and, usually, have little or no relation to the fair-market value of the asset in question. However, book value may approximate the cost of replacement shortly after assets are purchased.

The preceding are only some of the more common premises of value that an appraiser will encounter. The appraiser should be aware that there are other definitions that he or she may encounter.

.04 The issues of intellectual property require the accountant to focus on considerations that are different from those focused on by a typical business appraiser. For example, schools of thought often diverge on the issue of exactly what the relevant market is with respect to the asset at hand. These assets are often unique or have very specific applications that can complicate the task of defining the market. In fact, when evaluating damages relating to intellectual property matters, significant time is often spent in assessing the appropriate market in which the intellectual property would sell or operate. When evaluating intellectual property damages, the existence of substitute and/or competing products for the asset in question is often a very relevant issue that may require significant study. The typically diverse background of CPA valuation professionals makes them uniquely qualified to make these assessments. Further, the rights conveyed in the asset are central to correctly valuing the property. Does the buyer or licensee have all of the rights to the property or just limited rights?

The Engagement Letter

.05 An area that has attracted much attention recently is the drafting of engagement letters. This has been the case because appraisers are diversifying their practice areas and branching out to different clients to a greater extent than before. This is especially true with respect to the valuation of intellectual property. With today's technological advances and ever-changing business environment, the valuation of intellectual property is becoming one of most active areas of valuation. A key first step, after receiving adequate training in the area which can provide much protection to the appraiser, is the proper drafting of an engagement letter.

.06 In order to ensure an adequate understanding between the client and the appraiser, the following sections may be included in an engagement letter:

- A reference to the matter at hand and premise of value, (for example, fair-market value of XYZ Technology)
- The date of the appraisal
- The scope of services to be rendered (If it is unclear that certain services will be provided on an engagement, then the engagement letter should state that these services will be the subject of a subsequent engagement letter or client direction and should not be a part of the current document.)
- A discussion of the purpose and function of the analysis
- An understanding of what the value represents, for example, "the value of the ABC trademark for licensing purposes in the United States in association with apparel merchandise"
- For whom the work will be performed (Although this may seem inconsequential, work performed in the litigation environment is subject to discovery by the opposition under certain circumstances. However, in many jurisdictions, work for legal counsel on an engagement can be considered privileged and confidential under the rationale that the appraiser is providing consulting services to legal counsel and, as such, the discoverability of the appraiser's work product would jeopardize the plaintiff's or defendant's confidentiality and strategic position. It is recommended that if an appraiser performs valuation services in the litigation environment, he or she should be familiar with AICPA practice aids and special reports on litigation services.) (See list of consulting services publications in the back of this publication.)
- An understanding with respect to whom information will be disclosed (It is common for appraisers to limit the distribution of their work product to parties identified or as required by law.)
- An understanding of the limits of liability and indemnification of the appraiser or his or her firm with respect to the providing of services
- Billing arrangements including any retainers to be provided

- Areas for signature of all relevant parties (By signing the engagement letter, the relevant parties are acknowledging that they agree with the terms outlined in the letter.)
- Data to be provided by the client

Report Considerations

.07 The report will be governed in part by the terms of the engagement letter, including the purpose and function of the appraisal. If the report is to be used for purposes of litigation, then the consultant needs to be aware of any local jurisdiction rules that may apply. If the litigation is for a matter pending in federal court, the consultant should be aware of Rule 26 of the Federal Rules of Civil Procedure.

.08 Absent anything to the contrary, a report on the value of intellectual property should, at a minimum—

- Comply with the terms of the engagement letter.
- List the data and documents relied on in coming to the value determination.
- State the premise of value.
- State the purpose and function of the appraisal.
- Limit the users of the report.
- Cite the patent by number or, if not a patent, adequately describe the asset being valued.

.09 There may be instances that require far more in the valuation report. Likewise, for limited purpose reports, some of the information may not be necessary. However, the report should comply with the terms of the retainer agreement absent information to the contrary.

9. ACCOUNTING CONSIDERATIONS AND TAX LEGISLATION ASSOCIATED WITH INTELLECTUAL PROPERTY

.01 This segment of the practice aid will discuss tax legislation pertaining to intellectual property as well as generally accepted accounting principles (GAAP) for purchased intangibles under an allocation of purchase price scenario.

Generally Accepted Accounting Principles

.02 ***Background.*** In 1944, the Committee on Accounting Procedure (Committee) issued Accounting Research Bulletin (ARB) 24 "Accounting for Intangible Assets" which required purchased goodwill to be stated on the balance sheet as an asset. This asset was to be carried on the books either permanently or to be amortized on a systematic basis. Direct write-off of goodwill was not prohibited, however, it was discouraged. In 1953, the Committee issued ARB 43, "Restatement and Revision of Accounting Research Bulletins" which required a write-off of intangible assets that sustained a recognizable loss in value. This bulletin suggested writing off the lost value against earnings or retained earnings when recognized. A subsequent opinion issued in 1966, by the Accounting Principles Board (APB) Opinion No. 9, *Reporting the Results of Operations,* rescinded the write-off of lost value against retained earnings.

.03 In the late 1960s, the accounting profession and the Securities and Exchange Commission (SEC) reviewed the subject of accounting for intangible assets. Corporations were acquiring target companies for the principal purpose of reducing taxes and improving their earnings. The SEC and the accounting profession believed that this strategy could lead to the presentation of misleading financial statements.

.04 As a result, the APB issued Opinions 16, *Business Combinations,* and 17, *Intangible Assets,* which address the accounting treatment for business combinations and the resulting valuation of intangible assets.

.05 ***APB Opinions 16 and 17.*** APB Opinions 16 and 17, issued in August 1970, address accounting for business combinations and intangible assets, respectively. APB Opinion 16 relates to accounting treatment of an acquired corporation, and how it should be recorded on the surviving company's financial statements.

.06 According to APB Opinion 16, the surviving company can record the acquisition as a pooling of interest or as a purchase. These two methods of accounting can apply to both asset and stock purchases. On a pooling of interest basis, the recorded assets and liabilities of both companies are combined at their historical cost basis amounts. Therefore, the economic transaction still would result in recording no additional intangible assets. APB Opinion 16 lists twelve difficult-to-achieve criteria, all of which must be met to obtain pooling treatment. Therefore, in today's economic environment, most acquisitions were recorded under the purchase method. The accounting treatment is similar to the purchase of a single asset with the exception that the cost or price paid is allocated to the various classes or group of assets. The cost is allocated to each asset utilizing the basis of fair value. Under the purchase accounting method, APB Opinion 16 (par. 68) recognizes purchased goodwill as the difference between the sum of the assigned values of tangible and identifiable intangible assets less the liabilities assumed (as well as acquisition costs). Any premium or excess purchase price must be allocated to goodwill and going-concern value.

.07 APB Opinion 17 deals specifically with the acquisition, amortization, and accounting treatment of intangible assets in business combinations. It states that identifiable assets acquired as part of a business combination should be recorded at cost, based upon the fair value of the individual assets. The cost for unidentifiable intangible assets is the difference between the cost of the group's assets or enterprise acquired and the sum of the assigned costs of individual tangible and identifiable intangible assets less assumed liabilities. The principles and procedures for determining the cost of assets acquired is set forth in paragraphs 66 to 89 of APB Opinion 16 and related Interpretations.

.08 With respect to the amortization of intangible assets, APB Opinion 17, paragraph 27 states "that the value of intangible assets at any one date eventually disappears and that the recorded costs of intangible assets should be amortized by charges to income over the periods estimated to be benefited." APB Opinion 17 suggested that the following factors be considered in estimating the useful lives of intangible assets:

- Legal, regulatory, or contractual provisions may limit the maximum useful life.
- Provisions or renewal or extension may alter a specified limit on useful life.
- Effects of obsolescence, demand, competition, and other economic factors may reduce a useful life.

- A useful life may parallel the service life expectancies of individuals or groups of employees.
- Expected actions of competitors and others may restrict present competitive advantages.
- An apparently unlimited life may actually be indefinite, and benefits cannot be reasonably projected.
- An intangible asset may be a composite of many individual factors that have varying effective life.

.09 Accordingly, the period of amortization of intangible assets should be ascertained based on the aforementioned pertinent factors. Once the amortization period has been established, paragraph 30 of the APB concluded "that the straight-line method of amortization—equal annual payments—should be applied unless the company demonstrates that another systematic method is more appropriate."

.10 The FASB has issued the following pronouncements governing the accounting for intellectual property:

- FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*
- FASB Statement No. 44, *Accounting for Intangible Assets of Motor Carriers*
- FASB Statement No. 72, *Accounting for Certain Acquisitions of Banking or Thrift Institutions*
- FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of*

.11 In addition, the AICPA has issued accounting technical bulletins and other releases that may be relevant to intellectual property accounting issues to the extent it is necessary.

.12 ***Section 167 of the 1954 Internal Revenue Code.*** Section 167 of the IRC presents the framework for a reasonable allowance of amortization of intangible assets. In particular, IRC §1.167(a)-3 states the following.

> If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance. Examples are patents and copyrights. An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation. No allowance will be permitted merely because, in the unsupported opinion of the taxpayer, the intangible asset has a limited useful life. No deduction for depreciation is allowable with respect to goodwill.

.13 In order to amortize intangible assets and intellectual property under IRC §167, a taxpayer must prove that the intellectual property meets the following criteria.

- The intangible property must have an ascertainable cost basis separate and distinct from goodwill and going-concern value.

- The intangible property must have a limited useful life, the duration of which can be ascertained with reasonable accuracy.

If the factual depreciation standard is not met, then the asset becomes part of the goodwill and going concern of the business under the so-called *mass asset rule.* Thus the assets are amortized as part of a group or mass of assets.

.14 ***Section 1060 of the Internal Revenue Code.*** Since the introduction of APB Opinion 16, taxpayers and the IRS have had a difference of opinion regarding the proper purchase price allocation techniques to be utilized in connection with a purchase. Many of these disputes center around the amount of the purchase price allocated to goodwill and going concern. In April 1985, temporary regulations were introduced whereby certain stock purchases could be treated as asset purchases. IRC Section 338 spelled out the procedures to be used in allocations of this kind.

.15 The Tax Reform Act of 1986 made some fundamental changes to the federal income tax system. One of these changes was the adoption of the procedures established by Temporary Regulations 1.338(b)-2 that incorporated them in IRC Section 1060. This new section of the Code pertains to the allocation of purchase price in applicable asset acquisitions.

.16 IRC §1060 determines how the purchase price is allocated among the assets. Assets are categorized into four classes. The purchase price is then allocated starting with the first asset classification and then continuing to the final asset classification, which is class IV. The four classes of assets are as follows:

- *Class I.* Cash, demand deposits, and like accounts in banks, savings and loan associations, and other depository institutions
- *Class II.* Certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency
- *Class III.* All assets other than class I and class II, or class IV, and that may be tangible or intangible in nature
- *Class IV.* Intangible assets in the nature of goodwill or going-concern value

.17 IRC §1060 utilizes the *residual approach*, which is discussed later in this practice aid, to determine goodwill under an allocation-of-purchase-price scenario. In addition, this section of the IRC requires that both the buyer and seller agree to use the residual method to record the transaction.

.18 ***Section 338(h)(10) of the Internal Revenue Code.*** A practitioner should be aware that IRC §338(h)(10) applies to certain transactions. This section of the IRC addresses transactions whereby the seller is a subsidiary member of an affiliated group of companies and is eligible to choose to structure a transaction by filing either a 338(h)(10) or 1060 election. In general terms, IRC §338(h)(10) allows a selling consolidated group to make a joint election with a purchaser to treat a qualified sale of at least 80 percent of the target corporation's stock as a deemed asset purchase in which the target corporation recognizes gain or loss on the transaction as if it had sold all of the assets in a single transaction as of the close of the transaction date, while it was a member of the selling consolidated group. Thus, the selling consolidated group must report the gain or loss on the deemed asset sale resulting from the IRC §338(h)(10) election. (Cross, Tax Management. Purchase Price Allocations and Amortization of Intangibles (Washington, D.C.: Tax Management Inc., 1991) p. A-17)

.19 The eligibility requirements of a 338(h)(10) transaction are as follows.

- Target corporation must be a subsidiary, not a parent, in a selling consolidated group that files a consolidated tax return.
- The acquiring corporation must make a regular 338 election.

.20 It should be noted that IRC §1060 and 338(h)(10) both utilize the residual method of allocating the price of the transferred assets to particular classes of assets. However, there are certain situations in which the classification of assets differ. Whereas under a 338(h)(10) election, the gross amount allocable is equal to the modified adjusted deemed sales price (MADSP). A 338(h)(10) transaction does not receive a reduction in applicable purchase price for transaction costs.

.21 Should a practitioner become involved in a purchase price allocation under a 338(h)(10) transaction, it is advisable to discuss the transaction in detail with legal counsel in order to fully comprehend the nuisances of the transaction and allocation procedures.

.22 ***Section 197 of the Internal Revenue Code.*** Although IRC §1060 addresses the allocation procedures, the major source of continuing arguments with the IRS relates to class III assets. If the taxpayer takes an aggressive position in order to minimize the amount of goodwill which may not be amortizable, the IRS counters by invoking its authority to provide its own independent valuation of goodwill and going-concern. A recent Supreme Court decision, *Newark Morning Ledger Co. v. United States*, clarified the issue as to whether certain kinds of intangible assets are amortizable for tax purposes.

.23 In order to remedy this ongoing argument, a key tax provision was enacted in the Omnibus Budget Reconciliation Act of 1993. IRC §197 addresses the amortization of goodwill and intangible assets. IRC Section 197 allows most acquired intangible assets, including goodwill and going-concern value, to be amortized on a straight-line basis over a fifteen-year period. The ten- or twenty-five-year amortization of the cost of franchises, trademarks, or trade names was repealed. Essentially, the law allows for the amortization of certain intangible assets that were not amortizable under prior tax legislation. It also requires a fifteen-year amortization for intangible assets that were previously amortizable over longer or shorter periods.

.24 The following intangible assets are amortizable over fifteen years, if they were acquired after August 10, 1993:

- Goodwill
- Going-concern value
- Information base, including business books and records, operating systems, technical and training manuals, and accounting and inventory control systems
- Know-how and similar items, including secret formulae, processes, designs, patterns, and similar items (Further, any interest in a film, sound recording, videotape, book, or other similar property that is acquired in connection with the acquisition of a trade or business.)
- Customer-based intangibles, including the deposit base of an acquired financial institution, purchased mortgage servicing contracts, investment management contracts, subscription lists, insurance expirations, patient or client files, and advertisers' files
- Supplier-based intangibles, including favorable supply contracts

- Government-granted rights, including patents and copyrights acquired in connection with a business acquisition, liquor licenses, FCC licenses, cable TV franchises, taxicab medallions, and airport landing or take-off rights (or slots)
- Franchises, trademarks, and trade names
- Covenants not to compete and similar agreements entered into in connection with the direct or indirect acquisition of an interest in a trade or business

Certain kinds of intangible assets are excluded from the fifteen-year amortization rules, and they are as follows according to *Ernst & Young's Guide to the New Tax Law:*[100]

- Accounts receivable or other similar rights to income for goods and services provided to customers
- Rights to receive tangible property or services which were not acquired in connection with a business acquisition
- Interests in a corporation, partnership, trust, or estate
- Interests in certain financial contracts, including existing futures contracts, foreign currency, principal contracts and interest rate swaps
- Interests in land, including easements, mineral rights, timber rights, grazing rights, air rights, zoning variances, and other similar interests
- Computer software that is not acquired in connection with the acquisition of a trade or business
- Interests in films, sound recordings, video tapes, books, or other similar property that are not acquired in connection with a business acquisition
- Interests in patents or copyrights that are not acquired in connection with a business acquisition
- Interests in indebtedness
- Professional sports franchises
- Fees for professional services, and any transaction costs incurred by parties to a corporate nonrecognition transaction

.25 Although the effective date is August 10, 1996, the law does provide for this election to be applied to property acquired after July 25, 1996. If such an election is made by the taxpayer, it is applicable to all property acquired by the taxpayer after July 25, 1996. In addition to a discussion of amortization of intangible assets, the tax provision also addresses issues such as the loss deferral associated with the disposition of an intangible asset, tax treatment regarding the transfer of intangible asset in a nonrecognition transaction or transactions between related parties and an anti-churning rule pertaining to intangible assets that were not amortizable under prior law but that would be amortizable under the new law. Refer to IRC § 197 for a detailed discussion of the aforementioned issues.

.26 ***Section 482 of the Internal Revenue Code.*** One of the most intensely litigated areas in federal taxation over the past twenty or more years has been in the area of *transfer pricing.* Transfer pricing involves the determination of the price at which goods or *intangibles*[101] are transferred between related companies. Most of the interest has been in the international arena, where adjustments to intercompany pricing affects the amount of tax imposed on international transactions by the United States versus foreign jurisdictions.

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100 *Ernst & Young's Guide to the New Tax Law.* New York: John Wiley and Sons, Inc., 1993, pages 90–91.

101 The term *intangibles* is broadly defined to include patents, trademarks, tradenames, trade secrets, know-how, or similar items that produce a competitive advantage to the owner of the intangible.

.27 The litigation efforts by the IRS intensified in the 1970s and 1980s, primarily attributable to the establishment by U.S. multinationals of subsidiaries in Puerto Rico, in order to take advantage of the special tax exemption afforded by IRC Section 936. The strategy involved the transfer of patents, trademarks, trade secrets, and other valuable intangibles by high-tech companies, particularly pharmaceuticals and electronics, to their wholly-owned subsidiaries in Puerto Rico. The IRS noted that the development cost of these intangibles had previously been deducted in arriving at U.S. taxable income. The IRS challenged the amount of income reported by the subsidiaries in Puerto Rico on the basis that earnings attributable to the U.S. intangibles was being improperly shifted to Puerto Rico, either by the free use of the U.S. developed intangibles or by the inflated prices charged by the subsidiaries to their U.S. parent for goods manufactured using the intangibles. This challenge was based upon a very general provision, IRC Section 482, which gives the IRS broad authority to reallocate income or deductions between or among related entities in order to prevent the avoidance or evasion of tax. In interpreting the broad language of IRC §482, the courts considering the early cases were guided by a few early precedents and Treasury Regulations originally promulgated in 1968.

.28 On July 1, 1994, the IRS issued new final regulations on intercompany transfer pricing under IRC §482. These detailed regulations (comprising more than 250 pages) included a number of changes that took into account the comments and suggestions submitted with respect to the proposed and temporary regulations issued in January of 1993 (the 1993 regulations). The most important feature of the final regulations is the emphasis on comparability between a related-party transaction and a transaction between unrelated parties, analyzed in detail below.

.29 A more complete discussion of valuation methodologies with regard to transfer pricing will follow later in this practice aid.

10. VALUATION METHODOLOGIES AND PROCEDURES FOR INTELLECTUAL PROPERTY

.01 With each of the valuation approach and methods discussed below, it is very important for the practitioner to do an analysis of the market the particular asset, trade secret, patent, trademark, or other intangible will be utilized in. An assessment—though not necessarily a formal study—of markets, price elasticity, and alternative technologies is very often a critical input in an intangible asset valuation. Since a considerable portion of an intangible asset appraisal is based on defining relevant markets as well as the cash flows attributable to an asset, the CPA needs an understanding of economics and markets to perform most intangible asset valuation.

Market Approach Valuation Methods

.02 For most analysts, the first step in the intangible asset valuation process is to attempt to apply market approach method, sometime called sales comparisons. This is because the market—that is, the economic environment in which arm's-length transactions between unrelated parties occur—is usually the best indicator of the value of a discrete intangible asset. Analysts will analyze the market for both sales transactions and license (meaning, rental) transactions that may be useful in the analysis of the subject discrete intangible asset.

.03 There are somewhat fewer individual methods to select from within the market valuation approach, as compared to either the cost or income valuation approaches. Nonetheless, the practical application of a market approach methodology to an intangible asset appraisal is a complex and rigorous analytical process.

.04 The general systematic process used in applying the market approach to the appraisal of intangible assets may be broken down into the following five basic steps.

1. Research the appropriate exchange market to obtain information on sales transactions, listings, and offers to purchase or license guidelines (meaning, somewhat similar) or comparable (meaning, nearly identical) intangible assets that are similar or identical to the subject intangibles properties in terms of characteristics such as kind of intangible asset, intangible asset use, the industry in which the intangible asset functions, or the date of the sale and/or license.
2. Attempting to verify the information by confirming that the market data obtained are factually accurate and that the sales or license exchange transactions reflect arm's-length market considerations. (If the guideline transactions were not negotiated at arm's length, then adjustments to the transactional data may be necessary.) If performed, this verification procedure may also elicit additional information about the current market conditions for the sale and/or license of the subject discrete intangible asset.
3. Select relevant units of comparison (for example, income multipliers or dollars per unit) and develop a comparative valuation pricing analysis for each unit of comparison.
4. Compare guideline intangible asset sales and/or license transactions with the subject intangible, using the elements of comparison, and adjust the sales and/or license price of each guideline transaction appropriately to the subject property, if such an adjustment is not possible, or eliminate the sales and/or license transaction as a guideline for future consideration.
5. Reconcile the various value indications produced from the analysis of the guideline transactions into a single value indication or into a range of values. In an imprecise market, subject to varying economic conditions, a range of values may sometimes be a better conclusion for the subject intangible asset than a single-value estimate.

.05 When using the market approach, there are ten basic elements of comparison that may be considered in selecting and analyzing guideline intangible asset sales and/or license transactions. These ten basic elements of comparison are the following:

1. The specific legal rights of intangible asset ownership that were conveyed in the guideline transaction
2. The existence of any special financing terms or other arrangements (for example, between the buyer and the seller)
3. Whether the elements of arm's-length sale and/or license conditions existed
4. The economic conditions that existed in the appropriate secondary market at the time of the sale and/or license transaction
5. The industry in which the guideline intangible asset was, or will be, used
6. The physical characteristics of the guideline sale and/or license properties, compared to the subject intangible asset
7. The functional characteristics of the guideline sale and/or license properties, compared to the subject intangible asset

8. The technological characteristics of the guideline sale and/or license properties, compared to the subject intangible asset
9. The economic characteristics of the guideline sale and/or license properties, compared to the subject intangible asset
10. The inclusion of other non-intangible assets in the guideline sales and/or transaction that may mean the sale of a bundle or a portfolio of assets, such as tangible personal property and/or real estate, as well as discrete intangible assets

.06 The last phase of any market approach valuation analysis is the reconciliation step. In this step, two or more value indications that have been derived from the guideline sale and/or license market data have to be synthesized into an overall value estimate. In the reconciliation step, the analyst summarizes and reviews the empirical data, the valuation analysis, and the result of each of the value indications. These value indications are then resolved into a range of values, a single-value indication, or a point estimate. It is important that the analyst consider the strengths and weaknesses of each guideline value indication derived, examining the reliability and appropriateness of the market data compiled and of the analytical techniques applied.

.07 ***Application of Market Approach.*** The premise behind the market approach is very similar to the concept of fair-market value. In fact, the very implicit characteristics, including the concept of a willing buyer and willing seller, are present in the market approach. The approach suggests that to determine the value of intellectual property, the appraiser can either look to similar intellectual property in the marketplace or guideline companies in the marketplace to arrive at an opinion of value. However, given that the logic behind the market approach relies on the existence of guideline market data, the appraiser must remember that intellectual property typically has unique characteristics. Therefore, the comparability of one particular piece of intellectual property to another may be suspect and the appraiser must exercise judgment in selecting intellectual property comparables.

.08 Like traditional applications of the market approach, the appraiser can attempt to ascribe value to a particular piece of intellectual property by looking to guideline assets that have been traded in the marketplace. However, unlike traditional applications of the market approach, data regarding exchanges of intellectual property are more difficult to uncover than, for instance, exchanges involving generic equipment. However, there are a number of sources available to the appraiser to assess the existence of market data. These sources can be broken down into three categories: periodicals and publications, professional organizations, and intellectual property World Wide Web sites.

.09 The following is an example of the market approach.

> The primary assets which the company wishes to sell are trademarks and trade names associated with greeting cards and gift wrapping. The company's Board of Directors has decided to sell these assets. Trademarks and trade names, unlike a patent, never expire as long as they are in use, so royalties are valued into perpetuity.

.10 Under the market approach, we examined market royalty rates as cited in industry-related license agreements. Our research in the greeting card industry indicated market royalty rates for trademarks and trade names ranged from 3 percent to 7 percent. A publicly traded company, in its December 31, 1995 Form 10K filed with the (SEC), cites royalty rates for license agreements in force. The royalty rates of these agreements for trademarks for use on greeting cards, stationery, tablets, and magnets range between 3 percent to 7 percent of net sales. A royalty rate of 5 percent was deemed to be appropriate for trademarks and trade names being considered for sale. Application of the royalty rate to anticipated revenues associated with the trademark was initially for a period of ten years, and then into perpetuity using a terminal period factor.

.11 Assumptions for our trademark valuation are listed in exhibit 2, "Market Approach Trademark Valuation."

EXHIBIT 2

MARKET APPROACH TRADEMARK VALUATION

Assumptions	
Initial Market	$ 100,000,000
Market Growth	3.0%
Initial % Penetration	20.0%
Increase in Penetration	5.0%
Growth Rate	3.0%
Royalty Rate	5.0%
Discount Rate	15.0%

Year	Potential Revenue (a)	Percent Revenue Associated with Trademarks (b)	Revenue Associated with Trademarks	Royalty Income (c)	Royalty Income Tax Effected	Present Value Factor (d)	Present Value
1998	100,000,000	20.0%	20,000,000	1,000,000	600,000	0.933	$ 559.503
1999	103,000,000	25.0%	25,750,000	1,287,500	772,500	0.811	$ 626.400
2000	106,090,000	30.0%	31,827,000	1,591,350	954,810	0.705	$ 673,244
2001	109,272,700	35.0%	38,245,445	1,912,272	1,147,272	0.613	$ 703,491
2002	112,550,881	40.0%	45,020,352	2,251,018	1,350,611	0.533	$ 720,095
2003	115,927,407	45.0%	52,167,333	2,608,367	1,565,020	0.464	$ 725,574
2004	119,405,230	50.0%	59,702,615	2,985,131	1,791,078	0.403	$ 722,069
2005	122,987,387	50.0%	61,493,693	3,074,685	1,844,811	0.351	$ 646,723
2006	126,677,008	50.0%	63,338,504	3,166,925	1,900,155	0.305	$ 579,238
2007	130,477,318	50.0%	65,238,659	3,261,933	1,957,160	0.265	$ 518,796
Terminal Period					13,439,164	0.247	$ 3,321,956
				Present Value of Anticipated Royalty Income			$ 9,797,089
						Rounded to	$ 9,797,089

Notes:

(a) Revenues for 1998 projected to be $100,000,000. 1998 revenues grown at 3 percent annually for ten years.

(b) Revenue associated with trademarks was assumed to be 20 percent initially, based upon market penetration, growing 5 percent annually.

(c) Royalties calculated as 5 percent of revenues associated with trademarks based upon industry license agreements.

(d) Discount rate determined to be 15 percent, and a midyear convention was used to account for royalties received throughout the year, except for the terminal period value.

.12 At this point, the appraiser is cautioned that the economics between any licensor and licensee are dynamic, and motivations shift over time. Accordingly, an agreement entered into even a year ago may not be a good proxy upon which to value the subject property. Further, the competitive advantages of certain licensees may be better indications of investment value and not fair market value.

.13 With the sources listed in appendix A, "Intellectual Property Print and Electronics Resources," the appraiser can research the marketplace to find out whether there are transactions of comparable intellectual property. However, as mentioned previously, there are often challenges associated with this process. Either public information regarding transfers of intellectual property does not exist or, more often, the specific nature of the intellectual property being valued does not make it comparable to any other asset in the marketplace. Remember, comparability may need to be with regard to both characteristics and specific application. For example, a trade name licensed for clothing generally is not comparable to the same trade name licensed for perfume. The products and markets are very different. Given these challenges, the appraiser may adjust his or her application of the market approach or simply adjust the market indicators for the identified differences.

.14 If the appraiser thinks about the sale or exchange of businesses, he or she realizes that the price paid for a business is, most often, representative of the value of *all* of the assets being purchased. Thus, if the appraiser is able to ascribe value to all of the tangible assets involved in the purchase, he or she can arrive at a value for the intellectual property in question. However, any value that has not yet been realized, as a result of the fact that the property has not been fully exploited will not necessarily be captured using this method. Generally, however, the price paid for the business, less the ascribed value of all of the tangible assets, should, at least in theory, leave the appraiser with the value of the intangible assets in question. Nevertheless, that price represents the value of that asset in that particular business used along with the other assets of a company, which may not be subject to transfer.

.15 The issue at hand now becomes one of assessing the value of all of the company's tangible assets. It may be suggested that the appraiser can simply look to the financial statement of the company in question to arrive at the value of all of the tangible assets. However, keep in mind that financial statements are developed according to the standards outlined in generally accepted accounting principles (GAAP). GAAP dictates that the value of assets are recorded at the lower of market value or historical cost and, as such, will not be reflective of fair-market value. Certainly, if time and the budget allow, the company can solicit appraisals for all of its tangible assets, although in many instances this will not be feasible. If the company in question is a publicly traded entity, the stock market on which it is traded should dictate the current fair-market value of the company because the trading public will determine the appropriate per share price of the stock of the company. Still, as is often the case, the company holding the intellectual property asset may be privately held and therefore not actively traded in the marketplace. It is at this point that the appraiser must adjust his or her thought process about the market approach and develop a methodology to arrive at a reasonable estimate of fair-market value for the company. A common technique is to utilize the company's products or services and intellectual property in question. Use of the privately held company's financial ratios as a determinant of comparability is often successful. Throughout this process, the appraiser lets the marketplace determine the value of the guideline companies which in turn will suggest the fair-market value of the business and intellectual property in question. After this analysis is completed, the appraiser is left with the same exercise as previously discussed (meaning, subtracting the value of the tangible assets of the business from the purchase price to arrive at an estimate of the value of the intellectual property). The appraiser must remember, however, that the difference derived through this exercise is an unallocated value that is assignable to the firm's entire bundle of intangible assets and intellectual property. To the extent that various intangible and intellectual property assets exist within the company, the appraiser may then have to allocate the difference derived in the preceding exercise among all of the intangible assets in question, including the intellectual property asset. The appraiser can refer to some of the sources cited within this practice aid to ascertain the appropriate methodologies that exist to value other intangible assets.

.16 ***Special Issues of the Market Approach.*** As discussed previously, as many intellectual property assets are owned by privately held companies or individuals, the availability of information regarding sales and exchanges is limited in certain respects. Even though the appraiser may go through all of the preceding exercises, he or she may still be faced with the task of assigning the differential between the purchase price of a business and its underlying tangible assets to a group of intangible assets including intellectual property.

.17 Yet another potential drawback of using the market approach is that if another property is comparable and has been used as a guideline transaction, then the appraiser may need to determine that the substance of the underlying agreements is also similar to the pending transaction or use for which the property is being valued. All of these difficulties aside, the market approach, because it relies on values determined in the open market, is still a useful methodology for the appraiser to value intellectual property.

.18 ***Cost Approach Valuation Methods.*** The theoretical underpinnings of the various cost approach valuation methods for valuing discrete intangible assets relate to the following basic economic principles:

- *Substitution.* This principle affirms that no prudent buyer would pay more for a discrete intangible asset than the total cost to construct an intangible of equal desirability and utility.
- *Supply and demand.* Shifts in supply and demand cause costs to increase and decrease and cause changes in the need for supply of different kinds of discrete intangible assets.
- *Externalities.* Gains or losses from external factors may accrue to intangible assets. External conditions may cause a newly constructed discrete intangible asset to be worth more or less than its original cost.

.19 There are several groups of related valuation methods within the cost approach. Each group uses a similar definition of the kind of cost that is relevant to the valuation analysis. The most common kinds or definitions of cost include reproduction cost and replacement cost.

.20 There are subtle but important differences in the definitions of these kinds of cost. Reproduction cost contemplates the construction of an exact replica of the subject discrete intangible asset. Replacement cost contemplates the cost to recreate the functionality or utility of the subject discrete intangible asset, but in a form or appearance that may be quite different from the actual intangible asset subject to appraisal.

.21 Functionality is an engineering concept that means the ability of the subject intangible asset to perform the task for which it was designed. Utility is an economics concept that means the ability of the subject intangible asset to provide an equivalent amount of satisfaction.

.22 Although the replacement intangible asset performs the same task as the subject intangible asset, the replacement asset is often better in some way than the subject asset. In that case, the replacement property may yield more satisfaction than the subject property. If this is true, the analyst should be careful to adjust for this factor in the obsolescence estimation of the replacement cost analysis.

.23 The cost approach also encompasses several other definitions of cost. Some analysts consider a measure of cost avoidance to be a cost approach method. This method quantifies either historical or prospective costs that are not incurred by the intangible asset owner due to the ownership of the subject intangible asset. Some analysts consider trended historical costs as an indication of value. In this method, actual historical asset development costs are identified and quantified and then "trended" to the valuation data by an appropriate inflation-based index factor.

.24 All cost-approach methods include a comprehensive and all-inclusive definition of cost. It is important to recognize that the cost (whether replacement cost or reproduction costs) of a discrete intangible asset includes not only hard costs (for example, materials) and soft costs (such as engineering, design, labor, and overhead, but also the intangible asset developers profit on both the hard- and soft-cost investment and an entrepreneurial incentive to economically motivate the intangible asset development process. Moreover, the cost, however it is measured, of a discrete intangible asset should be reduced by all relevant forms of obsolescence, including economic obsolescence.

.25 So, although the cost approach is a distinct and different set of valuation analyses from the income approach, there are necessary economic analyses involved in the cost approach. These economic analyses, which may involve some analysis of historical or prospective income, provide indications of the appropriate levels of entrepreneurial incentive, if any, and of economic obsolescence, if any.

.26 The replacement cost of an intangible asset is the total cost to create, at current prices, an intangible having utility equal to the intangible asset subject to appraisal. However, the replacement intangible asset would be created with modern methods and constructed according to current standards, state-of-the-art design and layout, and the highest available quality of workmanship. Accordingly, the replacement intangible asset may have greater utility than the subject property.

.27 Reproduction cost is the total cost, at current prices, to construct an exact duplicate or replica of the subject intangible asset. This duplicate intangible would be created using the same materials, standards, design, layout, and quality of workmanship used to create the original intangible asset.

.28 Replacement cost new typically establishes the maximum amount that a prudent investor would pay for a discrete intangible asset. To the extent that an intangible asset is less useful than an ideal replacement asset, the value of the subject intangible asset must be adjusted accordingly.

.29 The subject intangible assets replacement cost new is adjusted for losses in economic value attributable to the following:

- Physical deterioration
- Functional obsolescence
- Technological obsolescence (often considered a specific form of functional obsolescence)
- Economic obsolescence (often considered a specific form of external obsolescence)

.30 Physical deterioration is the reduction in the value of a discrete intangible asset resulting from physical wear and tear resulting from continued use. Although it is unlikely that an intangible asset will experience physical deterioration, the analyst should consider this concept in any cost approach analysis.

.31 Functional obsolescence is the reduction in the value of an intangible asset due to its inability to perform the function (or yield the periodic utility) for which it was originally designed.

.32 Technological obsolescence is a decrease in the value of a discrete intangible asset resulting from improvements in technology that make an intangible asset less than the ideal replacement for itself. Technological obsolescence occurs when, due to improvements in design or engineering technology, a new replacement intangible asset produces a greater standardized measure of utility production than the intangible asset being appraised. As previously mentioned, technological obsolescence is often considered a specific form of functional obsolescence. Accordingly, many analysts capture all of the value influences due to both design flaws and changing technology in one category, which they call functional obsolescence.

.33 Economic obsolescence (a specific form of external obsolescence) is a reduction in the value of the subject intangible asset due to the effects, events, or conditions that are external to and not controlled by the current use or condition of the intangible asset. The impact of economic obsolescence is usually beyond the control of the intangible assets owner and is, thus, generally considered incurable.

.34 In estimating the amounts, if any, of physical deterioration, functional obsolescence, technological obsolescence, and economic obsolescence related to the subject intangible asset, the consideration of the subject intangibles actual age and its expected remaining useful life are essential to the proper application of the cost approach.

.35 Under the cost approach, a common formula for quantifying an intangible assets replacement cost is shown in the following formula:

$$\text{Reproduction cost new} - \text{Curable functional and technological obsolescence} = \text{Replacement cost new}$$

.36 To estimate the intangible assets value, the following formula may be used:

Replacement cost new	–	Physical deterioration	–	Economic obsolescence	–	Incurable functional and technological obsolescence	=	Value

.37 An intangible asset's deficiencies are considered curable if the prospective economic benefit of enhancing or modifying the intangible exceeds the current cost of the material, labor, and time needed to change it. An intangible asset's deficiencies are considered incurable if the current cost of enhancing or modifying the intangible (in terms of materials, labor, and time) exceed the expected future economic benefits of improving it.

.38 ***Income Approach Valuation Methods.*** Numerous measures of economic income may be relevant to the various income approach valuation methods. Some of these measures of economic income that may be relevant to the valuation of discrete intangible assets include the following:

- Gross or net revenues
- Gross income (or gross profit)
- Net operating income
- Net income before tax
- Net income after tax
- Operating cash flow
- Net cash flow
- Several others (such as incremental income)

.39 Given the different measures of economic income that may be used in the income approach, an essential element in the application of this valuation approach is to ensure that the yield discount rate or the direct capitalization rate used in the income approach analysis is derived on a basis consistent with the measure of economic income used.

.40 Although there are at least as many income approach valuation methods as there are measures of economic income, most of these methods may be grouped into several categories, all of which have similar conceptual underpinnings and similar practical applications.

.41 Several categories of discrete intangible asset income approach methods are listed below.

- Methods that quantify incremental levels of economic income (meaning, the discrete intangible asset owner will enjoy a greater level of economic income by owning the property as compared to not owning the property)
- Methods that quantify decremental levels of economic costs (meaning, the discrete intangible asset owner will suffer a lower level of economic cost, such as otherwise required investments or operating expenses, by owning the property as compared to not owning the property)
- Methods that estimate a relief from a hypothetical royalty or rental payment (meaning, the amount of a royalty or rental payment that the discrete intangible asset owner would be willing to pay to a third party in order to obtain the use of and rights to the subject intangible asset)

- Methods that quantify the difference in the value of the overall business enterprise or similar economic unit as the result of owning the subject intangible asset (and using it in the business enterprise)—as compared to not owning the subject intangible asset (and not using it in the business enterprise)
- Methods that estimate the value of the subject intangible asset as a residual from the value of an overall business enterprise or a similar economic unit, or as a residual from the value of an overall estimation of the total (meaning, collective) intangible asset value of a business enterprise or a similar economic unit

.42 All of the various income approach valuation methods may be grouped into the following two analytical categories:

1. Those that rely upon direct capitalization
2. Those that rely upon yield capitalization

.43 In a direct capitalization analysis, the analyst estimates the appropriate measure of economic income for one period (that is, one period future to the valuation date) and divides that measure by an appropriate investment rate of return. The appropriate investment rate of return is called the capitalization rate. The capitalization rate may be derived for a perpetual period of time depending upon the analyst(s) expectation of the duration of the economic income stream.

.44 In yield capitalization analysis, the analyst projects the appropriate measure of economic income for several discrete time periods into the future. This project of prospective economic income is converted into a present value by the use of a present-value discount rate. The present-value discount rate is the investor(s) required rate of return, or capitalization rate, over the expected term of the economic income projection.

.45 The duration of the discrete projection period and whether or not a residual or terminal value should be considered at the conclusion of the discrete project period depends upon the expectation of the analyst(s) concerning the duration of the economic income stream to be generated by the subject intangible asset.

The result of either a direct capitalization analysis or a yield capitalization analysis will provide an indication of the value of the subject discrete intangible asset.

.46 ***Application of the Income Approach.*** The income approach is probably the most often used approach for valuing intellectual property.

.47 As stated previously, the income approach determines a value based upon the economic benefits associated with the particular intellectual property in question. The most commonly utilized methods employed are as follows:

1. Discounted cash flow
2. Direct capitalization
3. Relief from royalty
4. Profit split
5. Excess earnings
6. Loss of income

.48 Another key element in developing an appropriate indication of value for intellectual property is the selection of an appropriate economic stream of benefits. Projected economic streams of benefits can be derived from average selling price differential, revenues, gross profit, gross and net cash flow, operating income, and net income, which are the frequently used measurement tools utilized by practitioners.

.49 *Discounted cash flow.* The discounted cash-flow technique is the sum of the present value of the projected earnings and cash-flow stream associated with a corporation's intellectual property over a specific period of time. Key factors to be considered in the valuation analysis are the following:

- Appropriate benefit stream attributable to the intellectual property
- Appropriate capitalization rate and discount rate
- Duration of the remaining life

.50 A practitioner should carefully examine each of the aforementioned factors. With respect to an appropriate benefit stream, the intangible asset ideally will have a historical track record of data from which to make an educated judgment. If the projected income stream is considerably higher or lower than its historical performance, examine the underlying assumptions to see whether or not the projected stream is realistic and attainable. The discount rate or capitalization rate should give consideration to the degree of risk associated with an investment in this asset as well as the probability of this asset achieving the projected income stream. The estimation of value of an asset is dependent in part upon the remaining useful life of the asset.

.51 The following concepts should be among those considered by the appraiser to assess the expected remaining useful life for intangible assets:

- Legal life
- Contractual life
- Statutory and judicial life
- Physical life
- Functional life
- Technological life
- Economic life

.52 Table 3, "Discounted Cash-Flow Method," is an example of the discounted cash-flow technique for the valuation of intellectual property and intangible assets. For ease of presentation, the returns associated with other assets of the business such as working capital, equipment, are not considered.

Table 3
Discounted Cash-Flow Method

The discounted cash-flow method projects expected benefits of an intangible asset and places a present value on them. This is a useful exercise for aging patients which may have a fixed or predictable life cycle. For purposes of this example, the return on all other assets is not considered.

Variable	Value
Projected Annual Revenues Attributable to Subject Patent	$ 5,000,000
Gross Margin	40%
Operating Expenses	25%
Income Tax Rate	40%
Revenue Growth Rate	7%
Discount Rate	15%
Estimated Life Expectancy of Patent	5 years

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	$ 5,000,000	$ 5,350,000	$ 5,724,500	$ 6,125,215	$ 6,553,980
Cost of Goods Sold	3,000,000	3,210,000	3,434,700	3,675,129	3,932,388
Gross Margin (40 percent)	2,000,000	2,140,000	2,289,800	2,450,086	2,621,592
Operating Expenses (25 percent)	1,250,000	1,337,500	1,431,125	1,531,304	1,638,495
Earnings Before Interest and Taxes	750,000	802,500	858,675	918,782	983,097
Income Tax Expense	300,000	321,000	343,470	367,513	393,239
Net Income	450,000	481,500	515,205	551,269	589,858
Add: Depreciation	100,000	110,000	121,000	133,100	146,410
Less: Capital Expenditures	150,000	165,000	181,500	199,650	219,615
Net Cash Flow	400,000	426,500	454,705	484,719	516,653
Discount Factor	0.8696	0.7561	0.6575	0.5718	0.4972
Present Value of Net Cash Flow	347,840	322,477	298,969	277,162	256,880
Indicated Value					$ 1,503,328

.53 In Table 3, it is assumed that the projected revenue is attributable to the patent being valued. Likewise, the costs are only the costs associated with the revenue of the patent. A closer look at the cash flows employed reveals that the model is being performed on a debt-free basis, thus, the discount rate employed may be the weighted average cost of capital (WACC). The WACC, depending upon the purpose and function of the appraisal, may be the WACC on a certain product or business division, for the entire company or for the particular patent if calculable.

.54 It is important to be able to isolate the benefit streams applicable to the asset being valued. For example, if the company has a very strong trade name, some of the cash flows may be in part attributable to that trade name and not a new technology.

.55 *Direct capitalization.* The direct capitalization method is the application of an appropriate capitalization rate (expected rate of return) to a normalized income level for the intellectual property or intangible asset. The valuation factors cited in the discounted cash flow approach are also applicable to this approach. This approach is useful if an income stream is attributable to a particular intangible asset. Table 4, "Direct Capitalization Method," is an example of the direct capitalization procedure for a license agreement.

Table 4
Direct Capitalization Method

The direct capitalization method projects a single period of expected benefits from an intangible asset and capitalizes the single period earnings. The capitalization rate accounts for both the discount rate and expected growth.

Variable	Value
Projected Annual Revenues Attributable to Subject Patent	$ 5,000,000
Revenue Growth Rate	7%
Discount Rate	15%
Income Tax Rate	40%
Estimated Life Expectancy of Patent	5
Present Value of an Annuity {1 - [1/(1+C)^N]}/C	3.99

Where N = Years and C = Capitalization Rate

	Next Year
Revenue	$ 5,000,000
Gross Margin (40 percent)	2,000,000
Operating Expenses (25 percent)	1,250,000
Earnings Before Interest and Taxes	750,000
Income Tax Expense	300,000
Debt-free Net Income	450,000
Add: Depreciation	100,000
Less: Capital Investments	150,000
Less: Additional Net Working Capital Investments	80,000
Net Cash Flow	320,000
Present Value of an Annuity Factor for 8 Percent (Discount Rate—Growth Rate)	3.99
Indicated Value	**$ 1,276,800**

.56 *Relief from royalty.* The relief from royalty approach is a commonly used technique employed in the valuation of intellectual property and intangible assets. Conceptually, a practitioner estimates the profit contribution associated with an intangible asset based upon a market royalty rate. The projected stream of royalty income is then discounted, at an appropriate rate, with the sum of the present values representing an indication of value for the intellectual property.

> The relief-from-royalty method is a form of discounted cash flow (income) approach premised on an analysis of the economic benefits provided to the owner of the intangible asset. If the intangible asset was not owned by its user, the user would normally have to pay the owner a royalty for the right to use the asset. The royalty is generally based on a percentage of revenues and is a function of the rights being granted (for example, exclusive versus nonexclusive) and other economic factors. The value of the intangible asset is measured

through a capitalization of cost savings afforded the owner by not having to pay royalties for the use of the asset.[102]

.57 Some commonly used approaches to arriving at a reasonable royalty rate are the following.

- The industry norms method focuses on royalty rates being charged within the industry for intellectual property.
- The return on research and development costs approach develops a reasonable royalty rate based upon the amount spent on research and development of the intellectual property.
- The return on sales approach, which is common, is based upon a percentage of revenues or net sales.
- Review of public filings such as 10Ks and 10Qs may provide information regarding royalty rates.

.58 Although the application of the relief from royalty approach is straightforward, it can produce unrealistic results based on the assumption of an inappropriate royalty rate. An example of the relief from royalty approach is shown in table 5.

Table 5
Relief From Royalty Method

The relief from royalty method calculates the pretax savings on a royalty, which need not be paid since the company in question already owns the intellectual property being valued. This calculation determines the market royalty that the company would be willing to pay for the right to use its patent were it owned by another entity. For the purpose of this example, the impact of taxes was ignored.

Variable	Value
Annual Projected Revenues Attributable to the Intangible Asset	$ 5,000,000
Revenue Growth Rate	5%
Royalty Rate (Market)	3%
Discount Rate	15%
Life Expectancy of Intangible Asset	Perpetuity
Revenues Attributable to the Intangible Asset	5,000,000
Market Derived Royalty Rate	3%
Projected Royalty Savings	150,000
Capitalization Rate (Discount Rate—Growth Rate)	10%
Indicated Value of Intangible Asset	**$1,500,000**

[102] James H. Zukin. *Financial Valuation: Business and Business Interests*. New York: Warren, Gorham and Lamont, 1995, page 13B. 3[4][6].

.59 *Profit split.* This approach assumes that the intellectual property or intangible asset is held by an independent third party (owner) who enters into a license agreement with another party (licensor) who in turn enters into a sublicense arrangement with another party (licensee). For example, the profit split method can be used when two or more parties are bringing assets to the table, and these parties and their assets provide different services or perform different functions. The resulting split percentage can be determined via an analysis of revenues and costs incurred or the fair-market value of assets contributed. Accordingly, the practitioner must ascertain the potential stream of income associated with the asset that could be hypothetically split between the prospective parties. The key elements inherent in the profit split approach are the following, according to *Valuing a Business,* by Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs:[103]

- Estimation of income
- Hypothetical split of income to hypothetical licensor and licensee
- Application of the split to estimated income generated by the intellectual property
- Appropriate discount rate or capitalization rate
- Capitalizing or discounting the estimated profit split

.60 As with any income approach, serious consideration and a thorough analysis of estimated income associated with the intellectual property is of primary importance. An example of the profit split method is set forth in table 6, "Profit Split Method."

[103] Shannon P. Pratt, Robert F. Reilly, and Robert P. Schweihs. *Valuing a Business,* Third Ed. Chicago: Irvin Professional Publishing, 1996, page 579.

Table 6
Profit Split Method

The profit split method assumes that a corporation would be willing to pay no more than a fixed percentage of its expected net income from an intangible asset for the right to use that asset. For this example, the percentage is assumed to be 50 percent for an even split. This method allows a quantification of income associated with an asset and yields an indication of its value. For purposes of this example, we have ignored the return(s) on other assets and any investment required to sustain assets.

Variable	Value
Projected Annual Revenues	$ 5,000,000
Operating Profit Margin	40%
Income Tax Rate	40%
Profit Split	50%
Revenue Growth Rate	5%
Discount Rate	15%
Projected Useful Life of Intangible Asset	Perpetuity
Revenues	$ 5,000,000
Operating Margin	40%
Operating Income	2,000,000
Taxes	800,000
After Tax Income	1,200,000
Profit Split Percentage	50%
Profit Split	600,000
Capitalization Rate (Discount Rate—Growth Rate)	10%
Indicated Value	**$ 6,000,000**

The profit split method is often confused with a rule-of-thumb approach. Unlike the rule-of-thumb approach, however, a profit split is not a blind acceptance of an economic arrangement.

.61 *Excess earnings.* The basic premise of this approach assumes that any earnings and cash flow that is in excess or above the required rate of return for its tangible assets is attributable to a corporation's intangible assets or intellectual property. The following definition is given in *Financial Valuation: Business and Business Interests* by James H. Zukin.

> In the excess-earnings method, the future cash flows of the company or other entity owning the intangible asset being valued are projected. A fair return on tangible assets must be subtracted, yielding the excess earnings attributable to all intangible assets. In determining the fair return on tangible assets, a fair rate of return on working capital and property, plant, and equipment must be determined.[104]

[104] *Ibid.*, Zukin, page 13B.3[4][c].
James H. Zukin. *Financial Valuation: Business and Business Interests: 1996 Supplement* New York: Warren, Gorham and Lamont, 1995, p. 13 B.3 [4][C].

.62 Since a corporation may possess more than one intangible asset, it may be necessary that a fair economic return be assigned to the other intangibles which would be valued on individually. Any residual cash flow would be associated with the goodwill/going concern of the business. An example of the excess earnings approach is presented in table 7, "Capitalization of Excess Earnings Method." Keep in mind that for purposes of simplicity, we have assumed only one intangible asset.

Table 7
Capitalization of Excess Earnings Method

The capitalization of excess earnings method calculates the expected return on all other assets, and attributes any earnings above and beyond this return to the intangible asset in question.

Variable	Value
Income Attributed to All Assets, Tangible and Intangible	1,500,000
Required Return on All Other Assets	20%
Estimated Value of All Other Assets	6,000,000
Sustainable Growth Rate	5%
Discount Rate	15%
Income	$ 1,500,000
Value of All Other Assets	6,000,000
Required Rate of Return on All Other Assets	20%
Required Return on All Other Assets	1,200,000
Excess Income	300,000
Capitalization Rate (Discount Rate—Growth Rate)	10%
Indicated Value of Unidentified Intangible Assets	**$3,000,000**

.63 *Loss of income.* The lost income or profits technique quantifies the amount of income or cash flow a corporation would lose if a particular intangible asset was not owned or licensed to the business. This approach requires the preparation of two scenarios, namely, one incorporating the utilization of the intellectual property and the other eliminating the intellectual property. The resulting difference between the two valuation scenarios represents the indicated value for the asset in question. This approach is useful in many instances especially in acquisitions. An example of a loss of income scenario assuming a trademark is used is shown in table 8. A scenario assuming a trademark is not used is shown in table 9.

Table 8
Potential Loss of Income Method

Value Assuming Trademark is Used

The potential loss of income method calculates the difference in income potential from the use of an intangible asset and not using the intangible asset. A trademark was used in this example to create a greater variation in values. It is assumed for the purposes of this example that a trademark will not only increase sales, but will allow a higher price to be charged, resulting in a higher margin. Obviously, in this example as in all examples, it is important to isolate costs and revenues associated with the benefits stream being created. Thus, very often, discussions arise concerning the costs and expenses associated with the revenues generated, which, for simplicity, are not necessarily limited to the intellectual property being valued.

Variable	Value
Projected Annual Revenues	$ 5,000,000
Projected Short-term Growth Rate	7%
Discount Rate	15%
Projected Long-term Growth Rate	5%
Projected Increase in Revenue	30%
Tax Rate	40%

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue with Trademark	$ 6,500,000	$ 6,955,000	$ 7,441,850	$ 7,962,780	$ 8,520,174
Cost of Goods Sold	3,250,000	3,477,500	3,720,925	3,981,390	4,260,087
Gross Margin (50 Percent)	3,250,000	3,477,500	3,720,925	3,981,390	4,260,087
Operating Expenses (25 Percent)	1,625,000	1,738,750	1,860,463	1,990,695	2,130,044
EBIT	1,625,000	1,738,750	1,860,462	1,990,695	2,130,043
Income Tax Expense	650,000	695,500	744,185	796,278	852,017
Net Income	975,000	1,043,250	1,116,277	1,194,417	1,278,026
Add: Depreciation	100,000	110,000	121,000	133,100	146,410
Less: Capital Expenditures	150,000	165,000	181,500	199,650	219,615
Net Cash Flow	925,000	988,250	1,055,777	1,127,867	1,204,821
Discount Factor	0.8696	0.7561	0.6575	0.5718	0.4972
Present Value of Net Cash Flow	804,380	747,216	694,173	644,914	599,037
Indicated Value					**$3,489,720**

Table 9
Potential Loss of Income Method

Value Assuming Trademark is Not Used

This method calculates the difference in income potential from the use of an intangible asset and not using the asset. A trademark was used in this example to create a greater variation in values. It is assumed for the purposes of this example. Also, the value of the trademark after year five is ignored.

Variable	Value
Projected Annual Revenues	$ 5,000,000
Projected Short-Term Growth	7%
Discount Rate	15%
Projected Long-term Growth Rate	5%
Tax Rate	40%

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue Without Trademark	$ 5,000,000	$ 5,350,000	$ 5,724,500	$ 6,125,215	$ 6,553,980
Cost of Goods Sold	3,000,000	3,210,000	3,434,700	3,675,129	3,932,388
Gross Margin (40 Percent)	2,000,000	2,140,000	2,289,800	2,450,086	2,621,592
Operating Expenses (25 Percent)	1,250,000	1,337,500	1,431,125	1,531,304	1,638,495
EBIT	750,000	802,500	858,675	918,782	983,097
Income Tax Expense	300,000	321,000	343,470	367,513	393,239
Debt-free Net Income	450,000	481,500	515,205	551,269	589,858
Add: Depreciation	100,000	110,000	121,000	133,100	146,410
Less: Capital Expenditures	150,000	165,000	181,500	199,650	219,615
Net Cash Flow	400,000	426,500	454,705	484,719	516,653
Discount Factor	0.8696	0.7561	0.6575	0.5718	0.4972
Discounted Net Cash Flow	347,840	322,477	298,969	277,162	256,880
Indicated Value					**$ 1,503,328**

Reconciliation of Two Scenarios from Loss of Income Method

Value With Trademark	3,489,720
Value Without Trademark	1,503,328
Value Attributable to the Trademark	**$1,986,392**

.64 Notice that in each instance, the discount rate and growth rate used are the same. This need not be true in every case, however. In each of the preceding examples, the valuation was premised on additional revenue and thus earnings. However, many inventions and trade secrets may not add revenue at all, but rather save expenses. Although the concept is exactly the same, the CPA should be aware and should quantify these kinds of benefits.

.65 ***Tax Benefit Calculation.*** The tax benefit rule, which is sometimes called a *tax shield*, is applicable in cases in which the intellectual property is acquired for tax purposes. In addition to the value of the intellectual property based on its economic benefits, consideration must also be given to tax savings due to amortization of the asset. Under this scenario, taxes represent another economic benefit. Thus, the total value of amortizable intellectual property is the sum of the present value of the economic stream and the present value of tax savings derived from amortization. The formula presented below captures the total value of the intellectual property:

TV = Total Value
TV = Pvc + (V(tr)(PVF))/RL
V = Tax basis of the intellectual property
Pvc = Present value of the pretax future benefits stream
RL = Remaining period for amortization based on future benefits
tr = The projected effective tax rate
PVF = The present value factor for an annuity over remaining life

.66 An example of the tax benefit formula under a relief from royalty approach is as follows:

Table 10
Tax Benefit Formula

Assumptions

A) Patent has a remaining economic life of five years
B) Royalty rate is 5 percent
C) Revenues attributed to patent are
Year 1 $2,000,000
Year 2 $2,500,000
Year 3 $3,000,000
Year 4 $3,500,000
Year 5 $4,000,000
D) Discount rate is 15 percent
E) Tax Rate is 40 percent

	Year	Revenue	Pretax Royalty Savings	Present Worth Factor	Present Worth
	1	2,000,000	100,000	.909	$ 90,900
	2	2,500,000	125,000	.825	$103,125
	3	3,000,000	150,000	.751	$112.650
	4	3,500,000	175,000	.683	$119,525
	5	4,000,000	200,000	.621	$124,200
Total				3.789	$550,400

$$V = \frac{(1 - .4) * \$550,400 * 5}{5 - (.4 * 3.789)}$$

V = $473,938

Proof:

V = $473,938

Full Amortization: $\frac{\$473,938}{5}$ = $94,938 per year

	Year 1	Year 2	Year 3	Year 4	Year 5
Pretax Royalty Savings	$100,000	$125,000	$150,000	$175,000	$200,000
Less: Amortization	94,788	94,788	94,788	94,788	94,788
Tax Savings	5,212	30,212	55,212	80,212	105,212
Less: Tax Rate (40 Percent)	2,085	12,085	22,085	32,085	42,085
Net Savings	3,127	18,127	33,127	48,127	63,127
Present Worth Factor (10 Percent)	909	.825	.751	.683	.621
Present Worth Income	2,842	14,955	24,878	32,871	39,202
Amortization	94,788	94,788	94,788	94,788	94,788
Less: Present Worth Factor (10 Percent)	.909	.825	.751	.683	.621
Amortization	86,162	78,200	71,186	64,740	58,853

Summary	
Sum of Present Worth Factor	$ 114,748
Sum of Present Worth Amortization	359,141
Total	$ 473,889*

*Difference from formula is due to rounding.

.67 The appraiser should utilize caution because the tax benefit rule is only applicable when the purpose of the appraisal is tax related. For purposes of ascertaining a value for the intellectual property, the practitioner utilizes the economic life of the asset. However, as previously discussed in this practice aid, amortization of certain intellectual property for accounting purposes is fifteen years (see the section herein entitled "Section 197 of the Internal Revenue Code.")

.68 ***Development of Discount Rates and Capitalization Rates for Intellectual Property and Intangible Assets.*** AICPA Practice Aid 93-3, *Conducting a Valuation of a Closely Held Business,* provides a detailed explanation of discount rates and capitalization rates as they pertain to the valuation of a closely held business. The practice aid cites several methods utilized in determining discount and capitalization rates, including the build-up method and capital asset pricing model. These approaches, among others, are utilized by practitioners in developing appropriate discount rates and capitalization rates.

.69 *Determination of the discount rate.* In discounting available cash flow, an appropriate rate of return must be determined. The rate of return expected by an investor from an investment is related to the following:

- The general level of interest rates
- A premium for perceived financial risk
- A premium for perceived business risk

.70 The appropriate rate of return in valuing the subject business is the cost of equity capital. This rate is referred to as the discount rate, which is determined using the summation method. The summation method essentially builds a discount rate using the various components that comprise the total rate of return required on an investment in the business. These components are (1) the total return required on a long-term, risk-free investment; (2) equity risk premium; and (3) increments for risk differentials of the business.

.71 Other risk factors are specific to the business and related to its advantages and disadvantages over other companies on the open market. These factors should include but not be limited to the following:

- The industry
- The financial risks
- The diversification of the operations
- Lack of management depth
- Lack of access to capital markets
- Geographic diversification
- Risk of assets
- Years in business

.72 After assessing for an overall specific risk premium the result, say, is a discount rate of 25 percent applicable to the entire business. Next, the analysts must isolate the discount rate applicable to the intellectual property.

> *Discount Rate Applicable to Intellectual Property.* The discount rate applicable to the intellectual property should reflect the rate of return an investor in the asset would require. For intangible assets, this rate is typically determined with reference to the discount rate of the business overall, which is 25 percent. This rate may be analyzed by viewing it as a weighted average of a series of discount rates applicable to the individual assets of the business.
>
> As stated earlier, one of the major characteristics of intangible assets recognized in GAAP is the characteristic of identifiability. Based on an analysis of the business and discussions with management, the analyst determines that an identifiable intangible asset is the intellectual property. The analyst obtains data demonstrating the existence of this asset, and performs an analysis enabling the estimate of the remaining useful life of the intellectual property. Under the standard of fair-market value, the intellectual property alone could be sold to a willing buyer; such a sale would not necessarily require a transaction involving the entire business, meaning, the other transferable assets of the business such as tangible assets and transferable intangible assets other than intellectual property. In fact, such customer-type intangibles often change hands without the simultaneous conveyance of the other assets of a business. We determine that the discount rate applicable to the intellectual property should reflect this lesser risk and conclude 20 percent as an appropriate discount rate for this asset.

For the purpose of this example, a schedule of adjusted assets and rates of return as of June 30, 199X is shown.

Assets	Fair-Market Value	Return (Percent)
Cash and Equivalents	$ 70,000	5.0%
Accounts Receivable—Trade	40,000	7.0%
Prepaid and Other Expenses	10,000	7.5%
Net Fixed Assets	80,000	8.0%
Intellectual Property	400,000	20.0%
Total and Weighted Average Return	$600,000	15.575%

Having identified all transferable asset value (except for unidentified transferable intangible asset value), the analyst can derive the rate of return applicable to the unidentified transferable intangible asset value. This approach will provide a logic to the appropriateness of the discount rates allocated for all component assets, thus lending credence to the discount rate assessed for the intellectual property. From previous work, the analyst may have determined the value of the business overall to be $1 billion. The determination of the rates for tangible and intangible assets and thus for intellectual property may be expressed in the following formula:

$$\$600{,}000\ (X) + \$400{,}000\ (Y) = \$1{,}000{,}000\ (25\%)$$

Where:

X = rate of return on identified tangible and intangible assets

Y = rate of return on unidentified intangible assets

The discount rate applicable to the unidentified transferable intangible assets is calculated as follows:

$$\$600{,}000\ (15.575\%) + \$400{,}000\ (Y) = \$1{,}000{,}000\ (25\%)$$
$$\$400{,}000Y = \$250{,}000 - \$93{,}450$$
$$\$400{,}000Y = \$156{,}550$$
$$Y = 39.14\%$$

Thus, we conclude that the discount rate applicable to the unidentified transferable intangible assets is 39.14 percent.

Determination of Economic Life for Intellectual Property. Ascertaining the economic life for an intangible asset or intellectual property is a necessary element in determining the value of the asset. A relationship exists between the value of an intangible asset and its expected economic life. Utilization of the income approach in arriving at a value for intellectual property supports the aforementioned claim. In *Valuation of Intellectual Property and Intangible Assets,* the following is stated.[105]

Economic life could be described as the period during which it is profitable to use an asset. Economic life ends when (1) it is no longer profitable to use an asset (the future benefits are used up) or (2) when it is more profitable to use another asset.

It should be noted that economic life may be longer or shorter than either legal or contractual life. Intellectual property that has renewal features tend to have economic lives longer than the contract life, whereas a patent in the software industry may have an economic life considerably shorter than its twenty-year legal life. The practitioner must be aware of internal and external forces that influence the economic life of an intangible asset.

In many instances, the most appropriate method for determining the economic life of intellectual property is by the use of quantitative analysis. One of the most widely used statistical methods is regression analysis. Regression analysis essentially provides a basis for predicting the economic life of an intangible asset by developing a statistical relationship based upon certain historical financial information pertaining to the asset in question. Since it is not the province of this practice aid to elaborate upon statistical techniques, the practitioner should review a statistics publication to get a better understanding of the aforementioned statistical model.

Another method of determining the economic life of intellectual property is by analyzing the historical rate of attrition associated with the asset. This method develops a retirement ratio based upon the number of retirements in relation to the total number of active accounts. An analysis of the age of the retirements can also provide some insight as to the expected economic life, especially if the inception date is available. These methods yield meaningful results if accurate data are available for an adequate period of time and the asset is relatively stable. These approaches may not be applicable for intellectual property in industries that are high tech or new and growing.

Another method of ascertaining economic life for intellectual property is by utilization of Iowa-type survivor curves. Such curves have been described as "based on a set of empirical data collected (mainly in the 1930s) for the purpose of statistically predicting future service expectancy (remaining service) for physical properties."[106]

Some practitioners have utilized this technique in developing an economic life for intellectual property. For a comprehensive explanation of the Iowa-type survivor curves, refer to bulletins 103,[107] 125,[108] 155[109] and 156[110] published by

[105] Gordon V. Smith and Russell L. Parr. *Valuation of Intellectual Property and Intangible Assets.* New York: John Wiley and Sons, 1989, page 295.

[106] *Ibid.*, page 393.

[107] Winfrey Robley and Edwin Kurtz. "Life Characteristics of Physical Property" (Ames, IA: Iowa Engineering Experiment Station, 1931), Bulletin 103, Vol. 30, #3.

[108] Winfrey Robley. "Statistical Analyses of Industrial Property Retirements" (Ames, IA: Iowa Engineering Experiment Station, 1935), Bulletin 125, Vol. 34, #28.

[109] Winfrey Robley. "Depreciation of Group Properties" (Ames, IA: Iowa Engineering Experiment Station, 1942), Bulletin 155, Vol. 41, #1.

[110] Winfrey Robley. "Condition-Percentage Tables for Depreciation of Unit and Group Properties" (Ames, IA: Iowa Engineering Experiment Station, 1942), Bulletin 156, Vol. 41, #2.

Iowa State University. The University has also published a textbook entitled "Engineering Valuation and Depreciation" that discusses the study of industrial property survivor curve characteristics.[111] A word of caution is called for regarding the utilization of Iowa-type survivor curves as a method of determining economic life for intellectual property. The assumption is that these curves as well as other survivor curves quantify all forms of depreciation. Survivor curves do not address external factors that may influence the economic life of an asset. The curves may serve as a guide, but should not be relied upon as conclusive proof of economic life for intellectual property. It is the obligation of the practitioner to review all pertinent information to arrive at his conclusion of economic life as opposed to a strict mathematical approach to arrive at a conclusion.

11. INTERNAL REVENUE CODE SECTION 482 PRICING

Transfer Pricing Methodologies in General

.01 ***Description and Application of Specified Methods.*** The 1994 final regulations (§ 1.482-3(a)) include the following transfer pricing methodologies found in the 1993 proposed regulations:

1. Comparable uncontrolled price (CUP) method
2. Resale price method
3. Cost plus method
4. Comparable profits method (CPM)
5. Profit split method
6. Unspecified methods[112]

.02 The first three methods just cited were included in the original Section 482 Regulations promulgated in 1968.[113] The CPM method was introduced in the 1993 Regulations, and was generally viewed as an overriding test for all other methodologies.[114] The potential use of unspecified methodologies has been increased[115] under the final Regulations, subject to the application of the Best Method rule. The profit split method, which was included in the 1993 Regulations with significant restrictions (and only in proposed Regulations format), has been included as a specified method under the final Regulations. Finally, the importance of CPM under the final Regulations is greatly diminished.

.03 *CUP method.* The CUP method determines an arm's-length price by comparing sales of identical products between unrelated parties. If such uncontrolled transactions exist, the pricing

[111] *Ibid.* Gordon Smith and Russell L. Parr, p. 321.

[112] As under the 1993 regulations (and unlike the original regulations issued in 1968), these methodologies do not have to be applied in the order listed. Rather, the most reliable method is determined by application of the best method rule (§ 1.482-1(c)), discussed in more detail in paragraphs 11.15 to 11.17.

[113] The 1968 regulations also recognized that "other methods" might be utilized if the CUP, resale price, and cost plus methods were shown to be inapplicable. Although the possible other methods were not specifically described, various forms of profit split methodologies were commonly used in practice. This methodology has now been specifically described and approved in the final regulations.

[114] In response to criticism of the provision of the 1993 regulations by commentators and our treaty partners, Treasury and IRS officials generally denied that this was the purpose of CPM.

[115] However, in view of the considerable flexibility of the specified methods, it should be possible (and clearly preferable) to avoid using unspecified methods.

employed between the unrelated parties would accurately determine the transfer price for transactions between related parties.[116] Of course, it is generally difficult to locate an uncontrolled transaction that is identical to the controlled transaction. The final regulations prescribe detailed factors (§ 1.482-1(d)) that are generally applicable under all transfer pricing methodologies for determining comparability. Additional rules for applying the factors related to the comparability of the controlled and uncontrolled transactions under the specified methodologies are also set forth, including those applicable to CUPs (§ 1.482-3(b)). Those rules state that, in applying the CUP method, product similarity is the most important factor to consider in determining comparability. Contractual terms and economic conditions between the controlled and uncontrolled transactions are also identified (§ 1.482-3(b)(2)(ii)) as requiring close similarity, unless adjustments can be made to account for any differences.

.04 The 1993 regulations imposed significant limitations on the use of transaction-based transfer pricing methodologies, particularly the CUP method. Thus, it was necessary to identify a transaction between uncontrolled parties involving virtually the same product sold under identical circumstances as the controlled transaction in order to use a CUP[117] to establish a transfer price. Methods using functional comparables (meaning, the resale price method and cost plus method),[118] as opposed to product comparables, were required if the CUP standard could not be met. Under the final regulations, the definition of comparability (§ 1.482-1(d)(2)) states that an uncontrolled transaction "need not be identical to the controlled transaction, but must be sufficiently similar that it provide a reliable measure of an arm's-length result." The final regulations permit use of the CUP method if adjustments can be made for "minor differences" between the controlled and uncontrolled transactions that have a "definite and reasonably ascertainable effect on price." In addition, the final regulations permit adjustments to account for more significant differences, but provide that the reliability of the CUP method (for purposes of applying the Best Method rule) will be reduced.

.05 This focus of the final regulations on reliability, rather than absolute accuracy, is intended to permit more liberal use of "inexact comparables," subject to the application of the Best Method rule and the general standards of comparability set forth (§ 1.482-1(d)). The expansion of the use of so-called inexact comparables obviously provides greater flexibility in the determination of a transfer price, but also provides less certainty in the results of an audit by the IRS.

.06 *Resale price method.* The resale price method determines an arm's-length transfer price by reference to the gross profit margin realized in comparable uncontrolled transactions. This method is often utilized if there is a purchase for resale of tangible property and the reseller does not add substantial value to the property by physically altering the goods prior to resale.[119] This method cannot ordinarily be utilized if the controlled taxpayer uses intangible property to add substantial value to the goods being sold (§ 1.482-3(c)).

.07 Application of the resale price method is reasonably straightforward once appropriate data have been obtained. Under this method, the arm's-length price is determined by subtracting the

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[116] Thus, the final regulations (§ 1.482-3(b)(2)(ii)) specifically provide that the CUP method, properly applied, will generally provide "the most direct and reliable measure of an arm's length price."

[117] The 1993 regulations required (§ 1.482-3T(b)(2)) that the tangible property and circumstances of a controlled transaction be "substantially the same" as the uncontrolled comparable transaction. This test could be met only if any "minor differences" either had "no effect on the amount charged" or could "be accounted for by a reasonable number of adjustments."

[118] Although the 1993 regulations provided lower standards of comparability under these alternative methods (see § 1.482-1T(c)(2)(iv)), the preamble recognizes that, as a practical matter, "inexact comparables" would generally not be taken into account.

[119] *Physical alteration* for this purpose focuses on further manufacture, as opposed to packaging, repackaging, labeling, or "minor assembly" (§ 1.482-3(c)).

appropriate gross profit from the applicable resale price. See § 1.482-3(c)(2)(i). The *applicable resale price* is defined (§ 1.482-3(c)(2)(ii)) as being equal to either the resale price of the particular item of property involved or "the price at which contemporaneous resales of the same property are made." The *appropriate gross profit* is computed (§ 1.482-3(c)(2)(iii)) by multiplying the applicable resale price by the gross profit margin in the uncontrolled transaction. Although this method was also employed under the 1968 regulations, it is often difficult to ascertain the gross profit margins of competitors on a product-by-product basis.[120]

.08 As a practical matter, the resale price method will often be asserted by the IRS in situations in which a U.S. taxpayer's subsidiary performs a distributorship function in a foreign jurisdiction, and the IRS determines that most of the product's total value is generated in the United States. In such cases, the IRS will attempt to determine a comparable markup by third-party distributors (sometimes on products that are not entirely similar) in order to determine the alleged value of the distributorship function.[121] The arm's-length distributorship profit thus determined is then subtracted from the selling price used by the taxpayer's distributorship subsidiary to determine the arm's-length price of the product from the manufacturer parent to the distributorship subsidiary.

.09 In inbound transactions, however, the IRS is often inconsistent in its application of this method. For example, a U.S. distributorship subsidiary of a foreign-based automobile manufacturer will often be determined to have developed its own substantial trade name value or other significant marketing intangibles (meaning, independent of its foreign parent), or to have utilized some other significant valuable intangible in the distribution process. The resale price method ordinarily cannot be used in such circumstances, unless the value contributed by the distributorship's alleged intangibles can be accurately determined. In any event, the IRS will, by focusing on alleged intangibles of the distributorship subsidiary, generally find value (and, therefore, income in the subsidiary) beyond the profit attributable solely to the distributorship function. In such circumstances, significant adjustments can be proposed.

.10 *Cost plus method.* The cost plus method was also one of the methods prescribed in the 1968 Regulations. It is generally employed if products are manufactured without the use of valuable intangibles owned by the manufacturing entity, and are then sold to a related entity. Under this method, an appropriate profit markup is determined as a percentage of cost by comparison to profits earned in allegedly comparable manufacturing operations. Once the appropriate cost plus markup of the so-called contract manufacturer is determined, application of the method is mathematical: The markup is added to the taxpayer's cost, and the result is the arm's-length price.

.11 The IRS generally applies the cost plus method if the taxpayer develops a product in the United States and produces it in a foreign jurisdiction. In such cases, the related manufacturing subsidiary is determined by the IRS to be a contract manufacturer and its selling price to a related party is determined by the cost plus method. Not surprisingly, this method will generate the lowest profit for the foreign-based contract manufacturer subsidiary and the highest profit for the U.S. parent.

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[120] Indeed, commentators have frequently observed the potential conflict between antitrust laws and obtaining data needed for transfer pricing determinations. The degree of comparability between controlled and uncontrolled transactions using the resale price method is also determined under the general principles of § 1.482-1(d). See § 1.482-3(c)(3)(ii).

[121] The difficulty, of course, is accounting for differences in markets, volumes, and contractual terms (meaning, risks assumed and services performed) between the independent manufacturer and distributor.

.12 *Other methods in penalty regulations.* The profit split method and the comparable profit method (see Part 4 below) are included in the final regulations as specified methods. The final regulations also include unspecified methods as permissible methods, whenever such methods provide the most reliable result under the Best Method rule discussed below.

.13 *Determination of arm's-length range.* The final regulations (§ 1.482-1(e)) contemplate the possibility that a proper application of any transfer pricing methodology may produce a permissible arm's-length range, rather than a specific price. Thus, the final regulations provide under each of the specified transfer pricing methodologies that such an arm's-length range may be determined by applying a single method to two or more uncontrolled transactions of similar comparability and reliability. If the actual transfer prices fall within the arm's-length range, an adjustment will not be proposed. (See § 1.482-1(e)(1).) This approach differs significantly from prior practice, according to which the IRS generally assumed that Section 482 of the IRC should be applied on the basis of a single price determined by the examining agent on audit.

.14 To determine an arm's-length range, the taxpayer must locate uncontrolled transactions that are comparable to the controlled transactions under the general principles of § 1.482-1(d)(2). These comparables must include underlying data that are sufficiently complete to show that material differences from the controlled transactions have been identified, and adequate adjustments have been made to eliminate the effects of such differences.[122] If the range cannot be determined by comparables of similar comparability and reliability as described in the preceding, all other valid comparables may be used, but the range should be adjusted by application of a valid statistical method.

Increased Emphasis on "Best Method" Rule

.15 ***In General.*** Under regulations in effect since 1968, it was required that the specified transfer pricing methodologies be applied in the specific order set forth in the regulations. Under the final regulations, the Best Method rule provides that the transfer pricing method selected must be the method that provides, under the facts and circumstances, the "most reliable measure" of an arm's-length result. The two factors to consider under the final regulations are the degree of comparability and the quality of the data and assumptions being utilized in the analysis. In addition, it may be relevant to consider the consistency of results between potentially competing methods.

.16 ***Determining Comparability Under the Best Method Rule.*** The generally applicable factors for determining comparability, as set forth in § 1.482-1(d)(1) and 1.482-1(d)(3), are incorporated into the best method rule. Under the general standards of comparability in the final regulations (§ 1.482-1(d)(2)), adjustments must be made to the extent possible to account for any material differences between the controlled and uncontrolled transactions. The number, magnitude, and reliability of any such adjustments will affect the overall reliability of the results. Moreover, an alleged comparable may possibly be used even if adjustments cannot be made for all material differences, with the inability to make such adjustments resulting in reduced reliability for the methodology. Thus, although the use of "inexact comparables" is not strictly precluded under the final regulations, careful analysis and judgment must be utilized in order to avoid the selection of a method that is not the best method.

[122] Thus, uncontrolled transactions that are arguably comparable, but which lack the same degree of comparability and reliability, may not be combined to establish the arm's-length range.

.17 ***Data and Assumptions Utilized.*** The completeness and accuracy of the data and the reliability of any assumptions made are also important in determining the overall reliability of a methodology in determining the best method as required by the final regulations. The extent of completeness of data will help to establish the existence or nonexistence of any differences between the controlled and uncontrolled transactions, and the accuracy of any adjustments made to account for any such differences. The sensitivity of the results to changes or deficiencies in the underlying data, or the reasonableness of any assumptions[123] made, are also to be taken into account in determining the reliability of the methodology under the best method rule. See § 1.482-1(c)(2)(ii)(C) of the final regulations.

Approval of Profit Split Method

.18 A transfer price can be determined under a profit split method (§ 1.482-6) by comparing the relative economic contributions that the parties make to the success of a venture, and dividing the returns from that venture between the parties on the basis of the relative value of such contributions. The final regulations limit this methodology to (1) comparable profit splits and (2) residual profit splits as defined therein.

.19 ***Comparable Profit Split.*** This methodology analyzes the combined operating profit of uncontrolled parties with transactions and/or activities that are similar[124] to those of the controlled taxpayers. The uncontrolled taxpayers' respective percentages of the combined operating profit is used as a basis for allocating the combined operating profit (loss) of the controlled taxpayers. Obviously, this method will be difficult to apply because data regarding the splitting of profits by uncontrolled parties will not generally be publicly available.[125]

.20 ***Residual Profit Split.*** The residual profit split method allocates the combined operating profit between the controlled taxpayers by the following two-step process:

1. Allocate income attributable to routine transactions to each controlled party. Under this step, each party is provided a market return on "contributions of tangible property, services, and intangibles that are generally owned by uncontrolled taxpayers engaged in similar activities." (See § 1.482-6(c)(3)(i)(A).)
2. Allocate residual profits remaining after allocation of routine contributions under step 1 above. These residual profits will generally be attributable to the controlled group's valuable intangible property, and are allocated among the controlled taxpayers based upon their relative contributions of such intangible property. The relative value of intangible property may be measured (a) by ordinary market value principles, (b) by capitalizing the development cost of the intangibles (less amortization based upon useful life), and (c) in certain circumstances, by comparison of the actual recent expenditures of the parties for relevant intangibles.

.21 ***Utilization of Profit Split Methodology Under the Penalty Regulations.*** Since a profit split relies at least in part on internally generated data, rather than transactions between uncontrolled parties, the IRS has historically viewed the profit split method as being generally less reliable

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[123] It should be noted that economic assumptions will generally be incorporated into a transfer pricing methodology. In fact, the regulations specifically recognize that "[all] methods rely on certain assumptions."

[124] In making this analysis, the general standards of comparability (§ 1.482-1(d)) are applied. However, comparability under this section depends particularly on the degree of similarity of the contractual terms of the controlled and uncontrolled transactions. See § 1.482-6(c)(2)(ii)(B).

[125] Accordingly, the residual profit split approach will generally be used whenever the profit split methodology is utilized.

than other methods relying on the results of arm's-length transactions. Therefore, under the proposed profit split provisions of the 1993 regulations, taxpayers were required to satisfy a number of procedural and substantive requirements in order to employ a profit split methodology. For example, the taxpayer was required under the 1993 regulations to make a binding election, which could be revoked only with the consent of the IRS, to use the method in all future years. Second, under the 1993 regulations, a profit split method could be utilized only if both of the controlled taxpayers owned so-called *valuable nonroutine intangible property* that contributed significantly to the combined operating profit derived from the relevant business activity. Both of these requirements have been deleted in the final regulations. Therefore, it is now possible to use the profit split method without a binding election and where only one of the controlled parties utilizes a so-called *valuable nonroutine intangible.* These changes are in accordance with the greater flexibility provided under the final regulations, but also highlight the importance of the application of the best method rule as discussed above.

Modification of Application of Comparable Profits Method

.22 The CPM analyzes the results of transfer pricing by comparing certain profit level indicators (for example, return on capital or financial ratios) with the indicators of uncontrolled parties engaging in similar activities. CPM was part of the 1993 regulations, which had provided that the CPM "ordinarily will provide an accurate measure of an arm's-length result." In response to concerns by commentators and our trading partners[126] that this method would be applied to the exclusion of all others, and would be inconsistent with the arm's-length standard generally applied worldwide, this language has been deleted. CPM is now included only as one of the methods potentially available,[127] as determined by application of the best method rule.

.23 In summary, the final regulations provide both more flexibility and more planning opportunities than were available under the 1993 regulations. Correspondingly, there is an increased possibility of challenge by the IRS on audit, and/or the imposition of severe penalties that are now available in the IRS arsenal, particularly the so-called *accuracy related penalties* under IRC Section 6662. The overriding concern among corporate tax executives in complying with transfer pricing rules is, of course, the avoidance of the imposition of these penalties (which range from 20 percent to 40 percent of the understatement of tax attributable to a transfer pricing misstatement). Analysis of transfer pricing methodology, and documentation of the methodology selected prior to the filing of the tax return, is therefore mandatory.

Data Collection and Retention Under Accuracy-Related Penalties

.24 In order to avoid accuracy-related penalties, the transfer pricing methodology and supporting data must be documented as part of the taxpayer's permanent tax record prior to the filing of a tax return that includes transfer pricing determinations. (See § 1.6662-6(d)(2)(iii) of the Penalty Regulations on the Accuracy Related Penalty under Section 6662(e) of the IRC, issued February 8, 1996 (herein referred to as the penalty regulations).

.25 Principal documents (§ 1.6662-6(d)(2)(iii)(B)) includes the following:

[126] The comparable profits method was not favored by our trading partners since it did not rely on data resulting from actual transactions between unrelated third parties.

[127] As noted in the preceding, the preamble to the final regulations states that the CPM "generally would be considered a method of last resort," since it would be applied only if available data for other approved methods are determined to be incomplete or unreliable.

1. An overview of the business (including an analysis of the economic and legal factors affective pricing)
2. A description of the taxpayer's organizational structure (including an organization chart)
3. Any documentation explicitly required by IRC Section 482 Regulations
4. A description of the method selected (and why selected)
5. Alternative method(s) considered and not selected (and why they were not selected)
6. A description of the controlled transactions and internal data used to analyze these transactions
7. A description of the comparables used and adjustments made (if any)
8. An explanation of any economic analysis and projections
9. A description of any relevant data obtained after the end of the tax year and before filing a tax return
10. An index of principal and background documents, and a description of the recordkeeping system used to catalog and access those documents

.26 *Note:* The penalty regulations added item 9 from the preceding list, which was not included in the prior temporary regulations, and also provide that both items 9 and 10 may be developed after the filing of the tax return for the period in issue under the contemporaneous documentation rules discussed in the following.

.27 Background documents (§ 1.6662-6(d)(2)(iii)(C)) include anything else that supports the assumptions, conclusions, and positions contained in the principal documents. Examples include documents listed in § 1.6038A-3(c) and not already described above.

.28 *Note:* The penalty regulations incorporate as an example (not mandatory) of background documents the documents listed in § 1.6038A-3(c), while specifically recognizing that all such documents "may not be relevant to pricing determinations under the taxpayer's specific facts and circumstances" and therefore would not be required to be retained.

.29 Transfer pricing analyses or studies prepared by economists and/or other consultants prior to the filing of the tax return may be taken into account in determining reasonable cause under the penalty regulations (§ 1.6662-6(d)(2)(ii)(D)). The fact that the economist or other professional is an employee of the taxpayer is not determinative in evaluating the reliability of that analysis or study.

.30 Consider the extent to which documentation maintained offshore should be retained as part of the transfer pricing file, whether or not this is strictly required by applicable rules and regulations. The inability to produce foreign-based documentation expeditiously often arouses unjustified suspicion on the part of the IRS and often leads to unnecessarily burdensome document requests. Better planning can reduce the likelihood of extensive formal document production requests.

.31 ***The Most Current Data Requirement.*** The Penalty Regulations modified the requirement to consider the most current data that was included in the prior temporary regulations. Commentators had expressed concern that a taxpayer could be required to consider data first obtained the day the return was filed, which would be impossible as a practical matter.

.32 Under the penalty regulations (§ 1.6662-6(d)(2)(ii)(B)), only data available to the taxpayer at the end of the taxable year need to be taken into account. Nevertheless, the penalty regulations further provide that if additional relevant data are obtained between the close of the taxable year and the date on which the tax return is filed, then such data must be included in the taxpayer's principal documents.

.33 The following is a summary of reliance on prior audit or APA methodology. Under the penalty regulations (§ 1.6662-6(d)(2)(ii)(F)), reliance by a taxpayer on a methodology developed in connection with an advance pricing agreement or specifically approved by the IRS pursuant to a transfer pricing audit is relevant in determining whether the taxpayer's efforts in applying a methodology is reasonable.

.34 The provision applies only if the method is applied consistently with its prior application and adjustments have been made for any material changes in facts and circumstances. This provision represents a significant departure from the traditional view of the IRS that nothing settled or conceded on audit is binding, or even relevant in subsequent audits. The scope and application of this provision awaits further development, since the IRS could be very strict as to what constitutes specific approval on audit or a material change of facts and circumstances, or whether adequate adjustments have been made.

.35 A comparison of methods (§ 1.6662-6(d)(2)(ii)) is required as part of the application of the best method rule (§ 1.482-1(c)(1)). The preamble to the penalty regulations observes that a comparison of methods is inherent in making the required analysis. The penalty regulations also retain the requirement that the comparisons of methods may be required, but, depending on the facts and circumstances, the evaluation may not entail an exhaustive analysis or detailed application of each method. See § 1.6662-6(2)(d)(ii).

.36 Finally, the reasonableness of the selection of methodology will be determined from all the facts and circumstances, including "the experience and knowledge of the taxpayer, including all members of the taxpayer's controlled group." See § 1.6662-6(d)(2)(ii)(A).

.37 *Note:* The preamble to the penalty regulations observes that commentators had objected to this provision, which was also included in the prior temporary regulations. However, being able to utilize the knowledge of the broader group in justifying a conclusion is perhaps more likely to benefit the taxpayer than the IRS. In any event, this requirement should be taken into account when documenting transfer pricing decisions.

Contemporaneous Documentation and Disclosure of Information

.38 The penalty regulations require that information retained to document the transfer pricing methodology must be produced within thirty days of a request by the IRS in order to be taken into account in determining the applicability of reasonable cause. See § 1.6662-6(d)(2)(iii)(A).

.39 *Note:* The preamble to the penalty regulations observes that commentators had argued that the thirty-day period was too short. In response, the preamble states that the thirty-day period is in the statute, and therefore cannot be changed, and, moreover, should provide enough time to disclose documents specifically prepared to provide to the IRS.

.40 The prior temporary regulations required specific disclosure for use of profit split or unspecified methods, or when a lump-sum payment for transferred intangibles was involved. This specific disclosure requirement has been eliminated from the penalty regulations.

.41 The IRS and the Treasury appear to have assumed in proposing the thirty-day rule in IRC § 6662(e)(3) and the corresponding penalty regulations that the taxpayer is limited, in defending a transfer pricing challenge by the IRS, to the results supported by the penalty-related documentation in the taxpayer's possession at the time the return is filed. The IRC (§ 6662(e)(3)(B)(i)(II) and (ii)(II)) and penalty regulations (§ 1.6662-6(d)(2)(iii)(A)) specifically require, however, only that the penalty avoidance documentation must be in existence when the return is filed, not that the documentation be included in the transfer pricing file at that time.

.42 Moreover, this requirement pertains only to information that is to be used to defend against a penalty, and does not necessarily exclude the use (in the Appeals Office or litigation) of information which is located subsequent to the filing of the return. Obviously, if such information eliminates a proposed transfer pricing adjustment, it likewise eliminates the accuracy-related penalty.

.43 Thus, the retained contemporaneous documentation can be used to support a finding of reasonable cause to avoid a penalty, while additional data located after the filing of the return, or even after the audit, can be used to eliminate a proposed transfer pricing adjustment. The taxpayer is, therefore, able to change its transfer pricing methodology, if necessary, based upon data (or analysis) discovered subsequent to the filing of the tax return. This would not defeat a finding of reasonable cause based upon the original contemporaneous documentation retained as part of the transfer pricing file.

.44 The supplementation of the contemporaneous documentation with information located after the filing of the return, but in existence if the return was filed, does not appear to be prohibited by a strict reading of the accuracy-related penalty provisions of the IRC and penalty regulations. Thus, the taxpayer should not be viewed as limited to information actually in the transfer pricing file at the time the return was filed, so long as all information is furnished to the IRS during audit within thirty days of request. Obviously, however, the best approach is to assemble the best contemporaneous documentation prior to the filing of the return.

.45 The IRS has summons authority, which means it can compel disclosure of additional documentation. The IRS is becoming more aggressive in obtaining transfer pricing materials not volunteered by the taxpayer, including materials potentially subject to attorney-client and/or work product privilege. See the following:

- *United States et al. v. Jack Bell, Individually and in His Capacity as Vice President and Chief Financial Officer of Conner Peripherals, Inc.*, 95-1 U.S.T.C. & 50,006 (N.D. Cal. 1994)
- *United States v. Monroe Adlman, as Officer and Representative of Sequa Corporation*, 94-2 U.S.T.C. & 50,389 (S.D.N.Y. 1994), aff'd, 68 F.3d 1495 (2d Cir. 1995)

.46 Transfer pricing data may also be obtained from third parties, and the IRS is becoming more offensive in this regard.

12 INTELLECTUAL PROPERTY LITIGATION

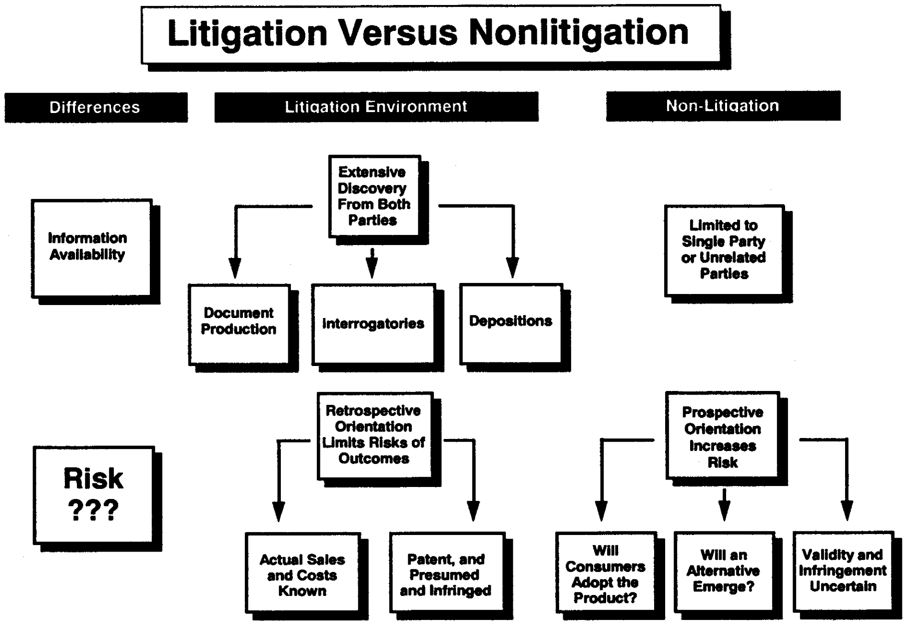
Overview

.01 In many intellectual property litigation matters, there are allegations that one party infringed upon another party's intellectual property rights, whether these rights pertain to patents, trademarks, copyrights, trade secrets, or a variety of other items. As such, the appraiser is often confronted with the issue of assessing the financial damages resulting from the alleged infringement. However, there is a significant difference between valuing intellectual property for a merger or acquisition, for example, and valuing intellectual property in litigation. When appraising intellectual property for nonlitigation engagements or for licensing considerations, the appraiser is often unaware of the cost structure of the other party to the transaction. As such, the appraiser must make certain assumptions with respect to costs to arrive at an opinion as to what the value of the intellectual property would be in this setting. In litigation matters, however, the appraiser often has knowledge of each or even both parties' cost structure because this information is usually subject to discovery by the parties involved in the litigation (that is, cost information is requested by and produced to either party).

.02 Case law in intellectual property matters is often categorized by kind of asset. For example, there is distinct case law addressing patents, trademarks, copyrights, and trade secrets. This practice aid does not include an exhaustive discussion on all areas of the law but provides a summary of some of the landmark cases which seem to have driven the manner in which damage calculations have been performed.

.03 The litigation environment commonly revolves around a dispute of value between one or more parties. This dispute can relate to the value of a business, asset, or any number of other issues. As such, the appraiser is often confronted with the task of quantifying the harm suffered by one entity due to the action (or inaction) of another entity or quantifying financial damages. Although many of the same techniques are employed, the valuation of businesses or assets does not equate to financial damages. There are certain other distinct differences between appraising assets for litigation versus nonlitigation purposes, as shown in exhibit 3, "Litigation Versus Nonlitigation."

EXHIBIT 3



.04 One of the main differences relates to information availability and how information is obtained. In the nonlitigation environment, the production of information is typically limited to the party requesting the appraisal. The procedures for producing this information are typically informal, because the requesting party is motivated to cooperate. However, in the litigation environment, the production of information often is a very formalized process. There are complex rules that govern what and how information is to be produced because litigation involves an adversarial proceeding, and the parties involved have a legal responsibility to produce information to the opposition. Moreover, this information could contain confidential and competitive data. Consequently, the parties involved often execute confidentiality agreements that preclude any party from disclosing sensitive information obtained through the course of "discovery," the legal term for the period in which parties are required to produce information to each other.

.05 Information in the litigation environment is produced pursuant to document requests, interrogatories, and depositions. Document requests are formal requests for information submitted to the opposition. Interrogatories are written questions that are submitted to the opposition which, when answered, become part of the legal record. A deposition is a forum in which the attorney for a party asks questions of a deponent under oath and is considered testimony. This testimony, unless otherwise prohibited by court order, is often discoverable in other litigation matters. This is an important fact because the appraiser should expect to be held accountable for opinions or answers given in prior proceedings.

.06 A second area in which the litigation environment is unlike the nonlitigation environment relates to the orientation of the appraiser. In a nonlitigation environment, there is generally a prospective orientation as the appraiser will be assessing the value of an asset with its potential for future benefit in mind. For example, the appraiser may focus his or her analysis on consumer demand for the product or whether an alternative substitute product will emerge such that it will affect the value of the intellectual property on a going-forward basis. However, in the litigation environment, the orientation of the appraiser is not only prospective, but retrospective as well. The appraiser often finds himself or herself looking back in time to factual data for purposes of ascertaining what should have transpired with respect to the sale or licensing of an intellectual property asset and comparing that to what actually transpired over time. Coupling this kind of analysis with an estimation of what will transpire in the future is often the framework for calculating damages with respect to intellectual property matters. This issue is discussed in more detail later in this practice aid.

.07 As a final note, given the differences in the role of the appraiser in the litigation environment, the risk of performing valuation services in the litigation environment should not be ignored. For example, the appraiser will often be called upon to render expert testimony regarding his findings and analysis. Testimony brings with it a heightened sense of responsibility because the testimony that may be given by the appraiser could have significant implications to the appraiser's professional reputation and future endeavors. Further, the level of scrutiny one encounters when providing expert testimony requires that the appraiser be well prepared to defend his or her analysis. Frequently, a significant effort is required to reach an appropriate level of comfort. The appraiser, as well as his or her client, must be aware that these kinds of considerations exist. This practice aid will provide various frameworks for items that will aid the appraiser in limiting his or her risks by accepting an engagement in the litigation environment.

Patent Infringement Damages

In patent infringement litigation, case law dictates that the claimant's damages, if proven, shall be adequate to compensate for the infringement but in no event shall the damages be less than a reasonable royalty. Accordingly, the focus on quantification of damages is an exercise of evaluating lost profits and/or a reasonable royalty. As noted in *Fromson v. Western Litho Plate & Supply Co.,* the calculation of a reasonable royalty is not a mere academic exercise in setting some arbitrary figure as a reasonable royalty. The determination still remains one of assessing financial damages to the injured party. Fortunately, subsequent case law provides the expert with further guidance on performing his or her analysis in this regard. This practice aid will attempt to educate the reader as to the chronology of case law that has had an impact on the calculation of intellectual property damages. The reader must be aware that case law in this area is constantly evolving.

> *Georgia-Pacific Corp. v. United States Plywood Corp. (1970).*[128] This case attempted to provide guidance on what factors were relevant for determining a reasonable royalty in patent infringement matters. Specifically, this case identified fifteen factors that should be evaluated by the expert to determine the reasonable royalty associated with an infringement. The analysis of these factors is guidance; other factors may also be relevant. The Georgia-Pacific factors include the following:

[128] Georgia-Pacific v. United States Plywood Corp., 318 F. Supp. 1116, (S.D.N.Y. 1970), modified 446 F.2d 295 (2d Cir. 1971), cert. denied 404 U.S. 870 (1971).

1. The royalties received by the patentee for the licensing of the patent in suit, proving or tending to prove an established royalty
2. The rates paid by the licensee for the use of other patents comparable to the patent in suit
3. The nature and scope of the license, as exclusive or nonexclusive; or as restricted or nonrestricted in terms of territory or with respect to whom the manufactured product may be sold
4. The licensor's established policy and marketing program to maintain his patent monopoly by not licensing others to use the invention or by granting licenses under special conditions designed to preserve that monopoly
5. The commercial relationship between the licensor and licensee, such as whether they are competitors in the same territory in the same line of business; or whether they are inventor and promoter
6. The effect of selling the patented specialty in promoting the sales of other products of the licensee; the existing value of the invention to the licensor as a generator of sales of his nonpatented items; and the extent of such derivative or convoyed sales
7. The duration of the patent and the term of the license
8. The established profitability of the product made under the patent; its commercial success; and its current popularity
9. The utility and advantages of the patent property over the old modes or devices, if any, that had been used for working out similar results
10. The nature of the patented invention; the character of the commercial embodiment of it as owned and produced by the licensor; and the benefits to those who have used the invention
11. The extent to which the infringer has made use of the invention; and any evidence probative of the value of that use
12. The portion of the profit or of the selling price that may be customary in the particular business or in comparable businesses to allow for the use of the invention or analogous inventions
13. The portion of the realizable profit that should be credited to the invention as distinguished from nonpatented elements, the manufacturing process, business risks, or significant features or improvements added by the infringer
14. The opinion testimony of qualified experts
15. The amount that a licensor (such as the patentee) and a licensee (such as the infringer) would have agreed upon (at the time the infringement began) if both had been reasonably and voluntarily trying to reach an agreement; that is, the amount which a prudent licensee—who desired, as a business proposition, to obtain a license to manufacture and sell a particular article embodying the patented invention—would have been willing to pay as a royalty and yet be able to make a reasonable profit and which amount would have been acceptable by a prudent patentee who was willing to grant a license

By addressing these questions on a case-by-case basis, the appraiser is at least asking the right questions to allow a reasonable royalty calculation to be developed. However, as *Georgia-Pacific Corp. v. United States Plywood Corp.* focused on a reasonable royalty calculation, the question still remained whether economic damages should be based on a reasonable royalty or a lost profits calculation. In 1978, *Panduit v. Stahlin Bros. Fibre Works, Inc.* shed some light on this issue.

Panduit Corp. v. Stahlin Bros. Fibre Works, Inc. (1978).[129] This case was a landmark for purposes of assisting the expert in determining lost profits or a reasonable royalty associated with an infringed patent because it expanded on many of the issues previously developed in *Georgia-Pacific Corp. v. United States Plywood Corp.* It is recommended that the reader become familiar with this case because of its significance to the calculation of intellectual property damages. Not only does this case develop a framework for assessing lost profits versus a reasonable royalty (often referred to as the Panduit Test), it provides a set of criteria that should be satisfied for a claim of lost profits to be reasonably successful. The Panduit test is not an exclusive test for lost profits.

King Instruments Corp. v. Perego and Tapematic, Inc. (1995).[130] This case revisits two areas that were previously touched upon by *Georgia-Pacific v. United States Plywood Corp.* Specifically, this case addresses the issue of causation in patent infringement matters and consideration for lost profit claim calculations. As *King Instruments Corp. v. Perego and Tapematic, Inc.* permits damages to be claimed on sales of competing products even though the patented technology was not even utilized, this indicates that experts should be cognizant of the implications of causation. Specifically, the case suggests that damages can be claimed "for any injury as long as it resulted from the infringement" and that "compensatory damages are generally those which are the natural result of the harmful act in question." Accordingly, this appears to expand upon the original scope of damages in certain instances suggested by prior case law and will direct the litigants to focus on causation issues as a strategy to address alleged damages.

State Industries, Inc. v. Mor-Flo Industries, Inc. (1990).[131] This case appears to diverge from the traditional concept of the absence of acceptable noninfringing alternative for purposes of developing a damage claim as contemplated under *Panduit v. Stahlin Bros. Fibre Works, Inc.* Under *Panduit*, to claim lost profits, the issue of whether there are substitute products in the market is very important (see the Panduit test below). Under *State Industries, Inc. v. Mor-Flo Industries, Inc.*, the patentee, in developing its lost profit claim, can seek to recover from the accused infringer a proportion of the accused infringers sales in the same ratio as the plaintiffs' sales in relation to the total market, even though alternative substitute products may exist. Thus, the plaintiff attributes the portion of sales lost in proportion to market share *after* adjusting for the infringing units.

Rite-Hite Corp. v. Kelley Co. (1995).[132] This case addressed the issue of claiming lost profits on convoyed sales, or sales of other products that occur as a result of sales of the patented item or process. Specifically, the focus was on the foreseeability of damages. Coupled with the implications made in *King Instruments Corp. v. Perego and Tapematic, Inc.*, these cases appear to have

[129] Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152, 1156 (6th Cir., 1978).
[130] King Instruments Corp. v. Perego, 65 F.3d 941, 952 (Fed. Cir. 1995) cert. denied, 1165 Ct. 1675 (1996).
[131] State Industries, Inc. v. Mor-Flo Industries, Inc., 883 F.2d 1573, 1579, (Fed. Cir., 1989), cert. denied, 493 U.S. 1022 (1990).
[132] Rite-Hite Corp. v. Kelley Co., Inc., 56 F.3d 1538 (Fed. Cir., 1995), cert. denied, 116 S. Ct. 184 (1995).

changed the scope of patent infringement damages. With regard to reasonable royalty calculations, it appears that many of the factors cited in *Georgia-Pacific Corp. v. United States Plywood Corp.* were downplayed as a royalty in excess of one-half of Rite-Hite's foregone profitability (and many times Kelley's actual profits) was affirmed on appeal. Likewise, this case softened the Panduit test by stating that Panduit's four-factor test was "...a useful, but non-exclusive way for a patentee to prove entitlement to lost profit damages."[133] Under the Federal Circuit Court's present view, damages for lost profits are no longer limited to lost profits on the patented item. After *Rite-Hite* and *King Instruments Corp.*, plaintiffs may try to increase their damage claims by adding areas of damages beyond those cited. Further, as stated previously, defendants will tend to fixate on causation issues. So what does this mean for the expert? It means that market research may be needed to provide an adequate basis to demonstrate the patent's causative effect on sales. Early involvement in the discovery process will also aid the expert in obtaining the information necessary to perform a meaningful analysis. Patent damage analyses should now focus on *all* potentially competing products and *all* markets in which the patent competes.

Markman v. Westview Instruments, Inc. (1996).[134] Argued in the Supreme Court of the United States, this case focused on whether juries have the authority to address damages in patent infringement matters. A lower court judge ruled that the court and not the jury had the authority to address patent infringement damages and the Supreme Court of the United States later upheld this ruling. As such, this may have significant implications in the future on the forum in which experts will be asked to render their professional opinions with respect to patent infringement matters.

In summary, it appears that the Federal Circuit has been moving towards a more liberal view of compensatory damages. Although the long-standing "but-for" test for causation still underlies all determinations of damages, the Court has expanded damages to the point that as long as the patentee shows that he or she has been injured by the infringer, he or she will be entitled to compensable damages.

Although the preceding cases only represent some of the more important decisions in patent infringement litigation, they suggest that the scope of the involvement of the expert has increased as a result of the changing case law and the courts have moved toward a more sophisticated recognition of the value of intellectual property.

Calculation of Patent Infringement Damages

.08 Patent protections are designed to promote invention and the proliferation of technology. These protections are limited in time frame and are generally intended to encourage commercialization. Awards granted under these protections are often designed to put the owner of the infringed technology in a position as good as the position that the owner would have been in infringement. In evaluating court decisions, caution should be employed because the court is free to allow many elements of the plaintiff's economic loss to be rolled into a damage determination including items such as lost market share, price erosion, lost profits on related but

[133] *Ibid.*

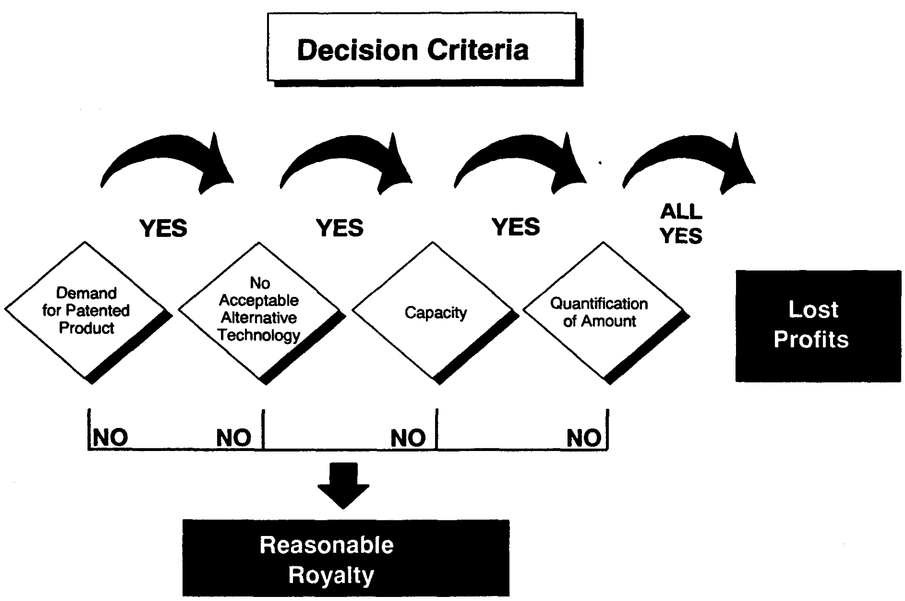
[134] Markman v. Westview Instruments, Inc., 517 U.S. 370 (Sup. Cir. 1996).

unpatented products, and lost profits on convoyed sales. Treble damage awards are often justified by commentators as helpful in discouraging patent infringement.

.09 As discussed in this practice aid, an infringed owner of a patent may seek recovery of either his or her lost profits, a reasonable royalty or, in certain circumstances, lost profits on some infringing sales and lost royalties on other infringing sales. The threshold for damages, however, is no less than a reasonable royalty. By comparison, remedies under circumstances of copyright infringement, trade secret misappropriation, or trademark infringement most typically include the lost profits of the intellectual property owner or the unjust enrichment of the infringer. Often in trademark matters, additional items are included in damage pleadings such as compensation for corrective advertising, punitive damages, and attorney's fees and costs.

> *Lost Profits.* As previously mentioned, *Panduit v. Stahlin Bros. Fibre Works, Inc.* provides guidance to the expert in deciding whether a claim should be based on a lost profits calculation or a reasonable royalty. Panduit is not an all-inclusive test for lost profits but rather should be viewed as an indicator that a claim for lost profits is a viable option. The Panduit test consists of four individual steps which usually are evaluated. Failure to answer "yes" to any of the four questions in the Panduit test suggests that the damage calculation may be more appropriately based on a reasonable royalty. This is illustrated in exhibit 4, "Decision Criteria."

EXHIBIT 4



> As is evident to the reader, the four tests within the Panduit test include the following.

1. Was there demand for the patent?
2. Was there an absence of acceptable alternative or substitute products available?
3. Did the owner of the patent have the capacity to produce enough units of the product so as to meet market demand as well as the capacity to market and sell them?
4. Can the amount of damages due to infringement of the patent and the resulting profit be adequately quantified?

If the appraiser answers *No* to any of these questions, then, for purposes of quantifying damages, the appraiser should develop a reasonable royalty calculation. Indeed, many times, counsel will request both a lost profits calculation and a reasonable royalty calculation. This is especially true if the patentee can only meet part of the demand satisfied by the infringer. Thus, if there are 100 infringing units and the patentee can only satisfy the demand for 25 units, they would be entitled to a reasonable royalty on the other 75 infringing units, all other things being equal.

Usually, demand for the patented product and the ability to quantify damages are relatively easy to prove. If nothing else, the fact that the infringer sold the infringing unit shows a level of demand.

Additional evidence that the plaintiff could have made the defendant's infringing sales may be required. This evidence could take the form, for example, of an analysis that reflects recognition of the effects of other competitors and their market shares as well as the potential for collateral sales. It may be appropriate to examine lost sales units and lost sales dollars per unit individually and then combine these effects to produce total (or by product) lost sales dollars.

Acceptable non-infringing alternatives can be challenging. This is more than just considering substitute products and often has to do with how a market for the product is defined.

Relevant costs, including incremental costs, should be associated with the incremental sales for the patentee. The analyst must be careful to include all relevant costs. For example, incremental costs will often include costs associated with production, manufacturing, marketing, sales, distribution, administration, as well as other costs.

With respect to a calculation of lost profits, the holder of the patent is only required to show a reasonable probability that it would have made the infringing sale. The patent owner need not negate every possibility that a purchaser might have bought another product or none at all. The main element of a lost profits calculation includes showing that there is a reasonable probability that the owner of the patent in question would have made the sale but for the infringement.

Given this postulate, there are various ways in which a lost profits calculation can be affected that can increase the scope of damages. Specifically, issues such as price erosion as well as *future* lost profits could increase a damage award. Price erosion can be argued if the patentee can show that the infringer's actions have caused prices in the marketplace to decline, and the patentee may recover damages associated with a lower price for its product. For example, assume that the patentee was able to show that due to the actions of the infringer, prices were lowered from $100 per unit to $80 per unit. In this situation, the patentee may be entitled to an award of $20 per unit for each unit the patentee sold in the marketplace. However, this analysis is not always a simple one. It is recommended that the expert ask certain questions that may lend to a critical assessment of the reasonableness to claiming price erosion. To the contrary, the expert should independently analyze to the extent considered necessary what the price of the plaintiff's product would have been if the defendant had not infringed. Also, given the structure of the market in which the patentee would have sold its product, is it reasonable to assert that the plaintiff would have sold as much product at the assumed higher price? In other words, what is the impact of price elasticity on the assumed level of sales? Very often, deposition testimony is used to support the appraiser's opinion.

An effective and commonly used format for analyzing lost profits damages is called, among other names, the three-column approach, the with and without approach, or the but-for approach. This approach, by whatever name, is a simple approach to analyzing damage situations where an "Actual Results" column of financial information is compared to "Should-Have-Been" or "But For" results column of financial information to arrive at an estimate of "Damages" or "Lost Profits" in the third column. An example of this approach is presented in the table 10, "The 'Three-Column Approach.' "

Table 10
The "Three-Column-Approach"

Income Statement

	Should-Have-Been Results	Actual Results	Lost Profits
Net Sales	$600,000	$500,000	$100,000
Less:			
Cost of Goods Sold:			
Variable COGS	264,000	220,000	44,000
Fixed COGS	80,000	80,000	0
Total COGS	344,000	300,000	44,000
Less:			
Operating Expenses:			
Variable Operating Expenses	60,000	50,000	10,000
Fixed Operating Expenses	100,000	100,000	0
Total Operating Expenses	160,000	150,000	10,000
Plus:			
Other Revenue Expense	13,000	13,000	0
Income (Profit) Before Tax	$109,000	$63,000	$46,000

The three-column approach may be easier for presentation purposes to show that each line item under the "Should-Have-Been Results" and the "Actual Results" is adequately addressed.

In addition to formulating an appropriate damage model and generally evaluating revenues and costs, the analyst in a patent lost profits calculation should make sure to also consider the following issues.

- Over what time period did the damages occur? Consider the following:
  —The number of periods of damages
  —Revenues or costs that are relevant for purpose of the damage calculation
  —The extent to which operational changes can reasonably be made by the patentee

- What are the timing and feasibility issues?
  —Required expansion or modification of manufacturing, selling, distribution, management capacity, and so on
  —Ability to obtain financing
  —Ability to "design around" the subject property
  —Entry of non-infringing competition

- What are the near-term or long-term lost sales?
  —Lost sales of the patented product or device
  —Lost sales of convoyed products
  —Lost sales of unpatented products as a result of the infringement
  —Lost sales due to weakened market share and competitive position

- What was the effect on sales prices attributable to price erosion resulting from increased competition?

- What were the changes in relevant near-term and long-terms costs?
  —Costs that vary with changes in volume included in costs of goods sold as well as selling, and general and administrative costs
  —Costs to expand capacity including manufacturing, distribution, selling, and other relevant costs

Reasonable Royalties. A reasonable royalty calculation is sometimes used as an alternative to the plaintiff's calculation of lost profits in the event that the patentee cannot prove lost profits. It also may be used in conjunction with a calculation of the plaintiff's lost profits or in lieu of lost profits. There are different approaches to determining a reasonable royalty. To aid in the assessment of these many methods, it is often useful to divide them into the following two general approaches:

1. An established royalty
2. Various analytical approaches.

As set forth in the cases cited earlier, the focus now appears to be more on the patentee's profits and much less on established arm's-length royalties. Apparently, this is intended to bring forward the concept of "damages adequate to compensate for the infringement." Sometimes, rules of thumb are also employed in reasonable royalty calculations. For instance, a rule of thumb might be 5 percent of gross sales, 25 percent of profits, and so on. However, rules of thumb are rarely appropriate and should not be used without independent verification through analytical methods. Likewise, because there is a split of profits, one should not assume a rule of thumb is being employed.

It is significant that in reasonable royalty cases, many courts have allowed analysts to incorporate into their calculations information based on the *actual* performance of the patented product and the actual costs of the patent owner and alleged infringer, versus exclusive reliance on the expected sales and costs as of the date of the first infringement, for purposes of determining a reasonable royalty. Of course, this is always applied to the *actual* infringing units. Very often, however, reliance on what was known or could have reasonably been known at the date of first infringement can govern. Thus, projections prepared prelitigation and preinfringement is a often useful basis for a royalty analysis but the projection may or may not be determinative.

In typical patent infringement litigation, the analysts will receive information upon which to base their calculations from legal counsel. Counsel in turn gets this information directly from their clients through interview and review of documents, and through discovery of the opposing parties' (and other third parties') records, to the extent necessary and available. Discovery will typically take the form of document productions, depositions of key knowledgeable individuals, and interrogatories. The analyst should try to work with his or her client's counsel, if requested, to ensure that adequate discovery is performed for the purposes of analysis.

An established royalty may result from earlier licensing transactions involving the infringed intellectual property. Alternatively, comparable licensing arrangements within the relevant industry involving similar technology may also be employed to infer a reasonable royalty for the subject technology. The analyst must be extremely careful in attempting to apply royalty rates from similar property to the subject property since, by its very definition, a patented product or technology is unique in some or many aspects. Caution should be exercised by the analyst even in situations in which the patent has been subject to license in the past because the past licensing arrangement may not reflect a relevant precedent for a reasonable royalty between plaintiff and defendant at the time of their hypothetical negotiation. Many differences may exist between the comparable license and the hypothetical license, including such factors as a different licensor, changes in the economy or competition within the industry, advances in allied or competitive technology, regulatory changes. Further, given the presumptions of patent validity and infringement of the patent, along with the knowledge that the patent is commercially acceptable, the hypothetical negotiations are very different than what normally takes place in true arm's-length negotiations.

There are different analytical approaches to determining a reasonable royalty. One analytical approach is based on the assumption that a valuable item of intellectual property will cause a business to achieve higher than normal returns. This method compares the expected profit margin for an enterprise with the intellectual property to the normal profit margin for similar businesses without the intellectual property. The difference represents excess returns from the intellectual property and can be used as an estimate for the royalty rate. Although this method has some theoretical and practical applicability, it also has some shortcomings.

Another analytical approach is called the comparative economics approach. Application of this approach requires a thorough understanding of the economics of the licensing transaction from perspectives of both the licensor and licensee. It should also reflect as many of the relevant microeconomic and macroeconomic factors that would go into a judgment regarding appropriate royalty rates. In essence, the analyst attempts to go back in time to determine an economically appropriate royalty rate as of the date of infringement using all relevant information known or potentially known at that time, and sometimes information known after the date of first infringement.

A hypothetical negotiation is assumed as of the time of first infringement between the potential licensor (the patent owner and plaintiff) and the licensee (the alleged infringer and defendant). The analyst should try to determine the financial effects or the true expected economics for both the potential licensee and the licensor. The analyst should also try to determine the maximum amount that the potential licensee would be willing to pay as a royalty. Intuitively, the licensee would be willing to pay up to the maximum amount that would be an acceptable economic return on all resources used in the production, distribution, selling, management, and financing of the product. If there are capacity constraints in the form of manufacturing, selling, administrative, or financing limitations, then the licensee's maximum payment may become bound by the return available to the licensee from its next best economic alternative. In other words, the licensee would not use its limited resources to license the product at issue unless the product promised a superior return in comparison to the licensee's next best alternative.

The licensor, on the other hand, would demand payment in the form of a license fee sufficient to make it better off than its next best alternative. The licensor's next best alternative may be to license the product to somebody else, make the product itself, not license the product at all, and so on. In summary, the licensor would demand a return at least slightly better than its next best alternative (but would, of course, consider any amount in excess of this minimum).

The overlap between the minimum that the licensor would take in the form of a royalty compared to the maximum that the licensee would be willing to pay for the royalty is the range within which the hypothetical agreement regarding a reasonable royalty should have been reached. The exact point within this range of overlap is determined by the analyst based upon review of other qualitative and quantitative factors that bear upon the strength of the negotiating positions of each party.

There may very well be situations in which there is no overlap. The licensor's expected return is sometimes far more than the infringer's expected return. Thus, the licensor's expected return is greater than the licensee's expected benefit. If these situations exist outside of the hypothetical negotiation, no agreement is reached. In the context of the hypothetical negotiation, the court essentially is going to force an agreement by determining a reasonable royalty that may be in the range in which no overlap exists. Therefore, the expert needs to carefully consider the Georgia–Pacific factors, market forces, and economics between the parties in order to establish a reasonable royalty.

In addition, cost and revenue issues such as those identified in the preceding in relation to the owner's lost profits calculations should be carefully considered in relation to both the potential licensor's and licensee's required returns.

There are other analytical approaches, including those encompassing required rates of return on investments and variations of cash flow models.

Future Lost Profits. With respect to future lost profits, patentees do not always consider the impact on future sales by infringers. Although the impact of past sales may be apparent, it is important to assess whether the future performance of the company will be adversely affected.

Situations in which future lost profits may be appropriate are often directly related to the effects of delayed entry into the market. For example, if Company A is infringing a product of Company B, it is possible that Company A can establish a market position that is far superior to Company B. If, during the pendency of the litigation, Company A establishes a noninfringing alternative to Company B's product, then the superior market position Company A established by infringing may be part of the damages Company B can claim if all burdens of proof are met. This analysis, of course, is not without obstacles, including determining the period of time into the future that should be part of the damage analysis.

Prejudgment Interest. Finally, the application of prejudgment interest can increase the damages in an intellectual property suit. Prejudgment interest represents the amount of money the plaintiff would have earned by reinvesting the profits that it lost during the period of infringement by the defendant. However, the calculation of prejudgment interest raises certain questions that should be addressed by the expert. Specifically, the appraiser is faced with the problem of evaluating the appropriate interest rate to use when calculating prejudgment interest. Often, legal jurisdictions indicate the prejudgment interest rate to be used to calculate prejudgment interest. If the appraiser is calculating intellectual property damages, it is suggested that he or she discuss appropriate case law with legal counsel before undertaking any analysis to independently develop a prejudgment interest rate.

Copyright Infringement

.10 Based in part on Title 17 of the U.S. Code, Section 504, an infringer of a copyright is liable for either the copyright owner's actual damages and any additional profits of the infringer or statutory damages as determined by a court of law which by statue cannot be less than $500 or more than $100,000. It is important to note that actual damages and profits can be considered the actual damages suffered as a result of the infringement and any infringer profits attributable to the infringement (and not previously determined). To support any calculation of damages, a copyright owner is required to present proof only of the infringer's gross revenues. Also, an infringer is entitled to prove his or her deductible expenses.

Trademark Infringement

.11 Similar to copyright infringement, a plaintiff is entitled to recover lost profits associated with infringement. In fact, case law exists that provides that lost profits can be awarded without showing actual product confusion. See *Taco Cabana, Inc. v. Two Pesos, Inc.* [1991].[135] However, there are also additional potential remedies available to the plaintiff in these kinds of actions. *Playboy Enterprises, Inc. v. P.K. Sorren Export Co.*[136] states that the court may award a plaintiff the defendant's profits as well as its own lost profits. By way of further example, courts have awarded expenses related to corrective advertising. To provide the reader with additional insight

[135] Taco Cabana International, Inc. v. Two Pesos, Inc., 932 F.2d 1113 (1991).
[136] Playboy Enterprises, Inc. v. P.K. Sorren Export Co., 546 F. Supp. 987, 1982.

into case law in this area, please refer to appendix C, herein, entitled "Summary of Cases Classified by Intangible Asset."

Theft of Trade Secrets

.12 With regard to cases involving theft of trade secrets, a plaintiff may recover damages for the actual loss caused by a misappropriation in addition to an amount representative of the defendant's unjust enrichment. If neither damages nor unjust enrichment is provable, the court may order payment of a reasonable royalty for not longer than the period of time the use could have been prohibited. If willful and malicious misappropriation exists, the court may award exemplary damages, usually calculated by multiplying the actual damages up to treble damages. But what exactly is misappropriation? Under case law, misappropriation constitutes the acquisition of a trade secret of another by a person who knows, or has reason to know, that the trade secret was acquired by improper means. Alternatively, it can be defined as the disclosure or use of a trade secret of another without express or implied consent by a person who utilized improper means to acquire the trade secret or at the time of disclosure, and who knew the trade secret was derived from a person who had acted by doing any of the following.

1. Utilized improper means to acquire it
2. Acquired it under circumstances giving rise to a duty to maintain its secrecy
3. Derived from a person who owed a duty to the person seeking to maintain its secrecy

Further, misappropriation can be classified as utilization of the trade secret when it is known that the secret was acquired by accident.

.13 This practice aid cannot discuss all of the different kinds of intellectual property litigation. Appendix C of this practice aid should provide the reader with some guidance as to the applicable case law with respect to various intellectual property issues. Nevertheless, the preceding discussion touches upon some of the more significant cases that have had a significant impact on intellectual property litigation and the role of the appraiser in that regard.

An Illustration

Background

This matter involves the latching lid mechanism (lock top) known as the "Gripsafe Locking Top" that is on plastic storage bins sold to consumers by grocery stores, hardware stores, and other outlets for home storage needs. For purpose of this illustration, the damages are being calculated as of December 31, 1995.

Assumptions of the Plaintiff

The plaintiff is an integrated manufacturer, producing plastic sheet as well as thermoforming. It developed and began using its newly developed latching lid mechanism in 1991. The Plaintiff offers approximately twenty-five products of different shapes, sizes, and so on. In 1992, the plaintiff notified the defendant of its alleged infringement of the "Gripsafe Locking Top" patent. Approximately 60 percent of the infringing sales are substitutes for the plaintiff's existing products. The plaintiff's sales force calls on substantially all of the defendant's customers. It has not licensed this patent or any other it considers similar. The plaintiff did offer a 6-percent royalty rate when attempting to reach an agreement prior to onset of litigation.

Assumptions of the Defendant

The defendant has been in business for ten years. It only thermoforms its products and purchases plastic sheet from third parties. In 1992, the company began converting some of its existing products to the alleged infringing locking top. Sales of the allegedly infringing product have increased from $1.2 million in 1992 to $30 million in 1995. The defendant offers approximately seventy-five products of different shapes, sizes, and so on. It has sold automated latching machines to certain of its customers. The old (noninfringing) locking tops did not perform as well as the infringing locking tops with this equipment. Although the defendant's sales of the machine are unknown to the analyst, available information suggests that the defendant spent approximately $1.5 million to convert its existing product line to the infringing locking top.

Financial Information

The following schedules provide summary financial data for the plaintiff and the defendant.

Schedule 1

Patent Owner and Plaintiff
Total Company Profit and Loss
For Years Ended December 31

	1995	1994	1993	1992	1991
Net Sales	$59,000	$49,000	$39,500	$33,000	$28,500
Cost of Sales	38,000	31,800	26,900	23,300	21,000
Gross Profit	$21,000	$17,200	$12,600	$9,700	$7,500
Selling	$7,400	$6,600	$5,900	$4,700	$2,900
Marketing	2,300	1,750	2,200	1,850	1,600
Administrative	3,300	1,000	980	960	1,500
Other	450	230	230	400	410
Total Expenses	$13,450	$9,580	$9,310	$7,910	$6,410
Operating Income	$7,550	$7,620	$3,290	$1,790	$1,090

Schedule 2

Patent Owner and Plaintiff
Product Line Profit and Loss—Analysis of Variable
For Years Ended December 31

	1995			1994			1993			1992		
	Total	Variable %	Variable Portion	Total	Variable %	Variable Portion	Total	Variable %	Variable Portion	Total	Variable %	Variable Portion
Net Sales	$12,600	100%	$12,600	$5,940	100%	$5,940	$3,600	100%	$3,600	$850	100%	$850
Cost of Sales	8,900	100%	8,900	3,900	100%	3,900	2,400	100%	2,400	590	100%	590
Gross Profit	$3,700		$3,700	$2,040		$2,040	$1,200		$1,200	$260		$260
Selling	$1,580	100%	$1,580	$800	100%	$800	$538	100%	$538	$121	100%	$121
Marketing	491	50%	246	212	50%	106	201	50%	100	48	50%	24
Administrative	705	25%	176	121	25%	30	89	25%	22	25	25%	6
Other	96	0%	0	28	0%	0	21	0%	0	10	0%	0
Total Expenses	$2,872		$2,002	$1,161		$936	$849		$660	$204		$151
Operating Income	$828		$1,698	$879		$1,104	$351		$540	$56		$109
Profit Margin	7%		13%	15%		19%	10%		15%	7%		13%

Schedule 3

Infringer and Defendant
Total Company Profit and Loss
For Years Ended December 31

	1995	1994	1993	1992	1991
Net Sales	$31,000	$26,800	$23,100	$21,000	$17,800
Cost of Sales	19,500	17,300	14,000	11,600	10,500
Gross Profit	$11,500	$9,500	$9,100	$9,400	$7,300
Selling	$4,600	$4,000	$3,400	$3,050	$2,450
Administrative	2,400	1,700	1,100	880	900
Pension	200	290	180	20	10
Interest	260	230	160	200	260
Total Expenses	$7,460	$6,220	$4,840	$4,150	$3,620
Operating Income	$4,040	$3,280	$4,260	$5,250	$3,680

Schedule 4

Infringer and Defendant
Product Line Profit and Loss—Analysis of Variable Costs
For Years Ended December 31
(000's)

	1995			1994			1993			1992		
	Total	Variable Percent	Variable Portion	Total	Variable Percent	Variable Portion	Total	Variable Percent	Variable Portion	Total	Variable Percent	Variable Portion
Net Sales	$30,000	100%	$30,000	$22,000	100%	$22,000	$10,400	100%	$10,400	$1,200	100%	$1,200
Cost of Sales	19,300	100%	19,300	14,200	100%	14,200	6,600	100%	6,600	700	100%	700
Gross Profit	$10,700		$10,700	$7,800		$7,800	$3,800		$3,800	$500		$500
Selling	$4,400	100%	$4,400	$3,200	100%	$3,200	$1,500	100%	$1,500	$170	100%	$170
Administrative	2,200	50%	1,100	1,400	50%	700	860	50%	430	115	50%	58
Pension	180	0%	0	240	0%	0	85	0%	0	13	0%	0
Interest	240	0%	0	195	0%	0	105	0%	0	14	0%	0
Total Expenses	$7,020		$5,500	$5,035		$3,900	$2,550		$1,930	$312		$228
Operating Income	$3,680		$5,200	$2,765		$3,900	$1,250		$1,870	$188		$272
Profit Margin	12%		$\boxed{17\%}$	13%		$\boxed{18\%}$	12%		$\boxed{18\%}$	16%		$\boxed{23\%}$

Schedule 5

Market Share—Use of Plastic Hinged Lid Containers

	Total Market	Infringed Market Total
Competitor A	30 %	20 %
Competitor B	25	15
Competitor C	15	10
Plantiff	10	20
Defendant	5	30
Other	15	5
	100 %	100 %

Discussion

This set of assumptions is purposely incomplete and somewhat ambiguous, so as to allow several different calculations of damages to be illustrated. If this were a real case, other analyses may be performed and a complete file of documents, depositions, and market analysis would exist.

Lost Profits

The plaintiff appears to pass the Panduit test as it appears that demand existed for the product, among other factors. For example, Schedule 4 documents sales of $30 million in 1995 alone. The plaintiff also appears to have adequate manufacturing and marketing capabilities to exploit the demand. As shown in Schedules 1 through 4, profits are readily calculable. One concern in the lost profit calculation, however, is the assumption regarding non-infringing substitutes as shown in Schedule 5. Clearly, there are a number of (assumed) non-infringing alternatives.

Ignoring the market share issue for a moment, if the analyst felt that the plaintiff would have been able to make all of the defendant's sales, then a simplified version of the plaintiff's lost profits calculation would be as shown in Schedule 6. An examination of Schedule 6 shows that the defendant's sales (the plaintiff's Should-Have-Been sales) are taken from Schedule 4 and represent the defendant's total sales of infringing products. The defendant's total sales are taken because the assumption for this calculation is that the plaintiff could have made all of the defendant's sales at the same price as the defendant. (In practice, this kind of assumption should be carefully evaluated.)

The plaintiff's incremental costs are used because the assumption is that the plaintiff would have manufactured, sold, and distributed all of the product actually made and sold by the defendant. Note that the plaintiff's costs are incremental to the anticipated volume (and not some version of average unit cost). The incremental costs were determined by doing a line-by-line analysis of each cost. The plaintiff's costs are from Schedule 2, the plaintiff's product line profit and loss statement. When the incremental profit percentage of the plaintiff is applied to the incremental sales the plaintiff would have made, the result is lost profits damages to the plaintiff.

Schedule 6

Alternative Damage
Damages Based on Lost
For Years Ended

	1995	1994	1993	1992	Total
Defendant's Net Sales of Allegedly	$30,000	$22,000	$10,400	$1,200	$63,600
Plaintiff's Incremental Profit Margin % of Net Sales	13%	19%	15%	13%	
Lost Profit	$3,900	$4,180	$1,560	$156	$9,796

Reasonable Royalties

The following discussion provides some insight into determination of reasonable royalty. The assumptions utilized for this illustration include the following.

- The plaintiff has not licensed this patent or any other it considers similar. It did offer a 6 percent royalty rate when attempting to reach an agreement prior to onset of litigation. Taken alone, this factor would tend to suggest a higher royalty rate than 6 percent.
- Approximately 60 percent of the infringing sales are substitutes for existing products of the plaintiff. Therefore, the plaintiff would lose considerable sales to the defendant and potentially be the victim of a generally lower selling price for its products due to increased competition. Taken alone, this factor would tend to influence the royalty rate upward.
- Incremental profit margins are 13 to 19 percent for the plaintiff. The profit margins represent areas of potential harm attributable to lost sales and the price erosion on other products.
- The defendant reaches certain parts of the market that the plaintiff will probably be unsuccessful in reaching. These are incremental or "found" sales to the plaintiff. Taken alone, this would influence the royalty rate downward.
- Using the plaintiff's patent, the defendant will achieve significant additional sales beyond those they could achieve without the use of the plaintiff's patent. Taken alone, this factor suggests that the royalty rate would be influenced upward.
- The defendant's profit margins are 17 to 23 percent. This factor is relevant to potential new sales of the defendant.
- The defendant has a machine (the latching machine) that may benefit from convoyed sales of the patented product. Taken alone, this factor may influence the royalty rate upward.

- Based on the market-share analysis, there are relatively similar noninfringing alternatives in the marketplace because costs to design around the plaintiff's design may be relatively low. Taken alone, this factor tends to influence the royalty rate downward.
- The defendant will have to make capital expenditures of approximately $1.5 million to exploit a license it might get from the plaintiff. Taken alone, this factor would influence the royalty rate downward.

Considering these and other factors, the analyst would apply one or more of the techniques described in this practice aid to determine a reasonable royalty. A reasonable royalty can be a lump sum or an ongoing royalty based on sales, net sales, gross profits, as well as any of many other bases. Often, a licensing arrangement may include combination royalties. For instance, certain lump-sum payments may be combined with a per unit royalty or an ongoing royalty of different amounts per dollar of sales.

Presented below as Schedule 7 is a calculation of an ongoing royalty of 5 percent of net sales. The royalty rate is based on the analyst's determinations of a reasonable royalty. The net sales base comes from Schedule 4, the infringing sales made by the defendant.

Schedule 7

Alternative Damage Theories
Damages Based on Reasonable Royalty
For Years Ended

	1995	1994	1993	1992	Total
Defendants Net Sales of Infringing Product	$30,000	$22,000	$10,400	$1,200	$63,600
Defendants Incremental Profit Margin % of Net	17%	18%	18%	23%	
*Reasonable Royalty Damages at 3%	$900	$660	$312	$36	$1,908
Reasonable Royalty Damages at 5%	$1,500	$1,100	$520	$60	$3,180
Reasonable Royalty Damages at 7%	$2,100	$1,540	$728	$84	$4,452

*The royalty rates selected in this example were not subject to proper analysis and rates much higher than 7 percent may be justified. This fact pattern is intentionally incomplete to stimulate thought.

Combined Lost Profits and Reasonable Royalty

As mentioned above, and in the text of this practice aid, there are certain circumstances in which the plaintiff in a patent infringement matter may be awarded both lost profits and a reasonable royalty. According to the *State Industries v. Mor-Flo Industries Inc.*[137] matter (as well as other cases), the plaintiff can seek to recover a proportion of the defendant's sales that is consistent with the plaintiff's relevant market share. The argument is that, absent the infringing sales by the defendant, the plaintiff would have secured a normal market share of those sales, all other things being equal. In this particular circumstance, the defendant had secured a 30 percent market share

[137] *Ibid.* State Industries vs. Mor-Flo Industries, Inc.

of the relevant products. The plaintiff had secured only a 20 percent share. Absent the participation of the infringing defendant, the plaintiff's market share would have been approximately 29 percent. The 29 percent represents the plaintiff's market share of 20 percent plus that 20 percent share divided by the remaining total market (absent the infringer's sales) of 70 percent times the 30 percent share of the market surrendered by the defendant {(20%+(20/70 x 30%)) =29%}. In other words, the infringer's share of the market is allocated back to the remaining (non-infringing) market participants based on the revised market share of the remaining market participants.

Other lost profits and reasonable royalty inputs are as shown in Schedules 6 and 7.

Schedule 8

Alternative Damage Theories
Damages Based on List Profits and Reasonable Royalty
For Years Ended December 31

		1995	1994	1993	1992	Total
Defendant's Net Sales of Allegedly Infringing Product		$30,000	$22,000	$10,400	$1,200	$63,600
Plaintiff's Incremental Profit Margin as a Percentage of Net Sales		13%	19%	15%	13%	
Defendant's Incremental Profit Margin as a Percent of Net Sales		17%	18%	18%	23%	
Market Shares:						
Plaintiff		20%	20%	20%	20%	
Defendant		30%	30%	30%	30%	
Other		50%	50%	50%	50%	
Sales Subject to Lost Profit	29%	$8,700	$6,380	$3,016	$348	$18,444
Sales Subject to Reasonable Royalty	71%	$21,300	$15,620	$7,384	$852	$45,156
Lost Profit Damages		$1,130	$1,212	$452	$45	$2,840
Reasonable Royalty Damages at 5 Percent		1,065	781	369	43	2,258
Total Damages		$2,196	$1,993	$821	$88	$5,098

13. CONCLUSION

.01 The practice aid was prepared under the premise that it would serve as a primer providing the practitioner with guidance in the valuation of intellectual property and determining infringement damages. It is by no means to be considered a complete or comprehensive publication; however, it will provide the practitioner with information regarding the pertinent issues that need to be addressed in the valuation process.

.02 The practice aid contains notes and/or citations that are relevant in the valuation process. We strongly urge that a practitioner read the pertinent notes and citations in order to get a better understanding of the facts. A practitioner undertaking the valuation of intellectual property for the first time is advised to collaborate with an experienced valuation consultant until the practitioner has gained the necessary experience or comfort level to prepare an intellectual property valuation. This practice aid provides the reader with sufficient facts and methodologies to embark on a valuation of intellectual property.

APPENDIX A

INTELLECTUAL PROPERTY PRINT AND ELECTRONIC RESOURCES

Periodicals and Publications

There are many periodicals and publications that either discuss, in detail, the valuation of intellectual property assets or contain market information regarding the sale, transfer, or exchange of intellectual property. Although it is not within the scope of this practice aid to identify all of the potential sources for this kind of information, some recommended sources include the following.

- *The Licensing Economics Review.* A West Inc. Morristown, NJ.
- *Les Nouvelles* (a journal of the Licensing Executives Society). Alexandria, VA. Licensing Executives Society (U.S.A. and Canada), Inc., 1997.
- *Intellectual Property Strategist.* Leadership Publications, New York.
- *Licensing of Intellectual Property.* Jay Dratler, Jr. New York: Law Journal Seminars-Press, 1994.
- *Licensing a Strategy for Profits.* Edward P. White. U.S.A.: Licensing Executives Society (U.S.A. and Canada), Inc., 1997.
- *Technology Licensing: Corporate Strategies for Maximizing Value.* Russell L. Parr and Patrick H. Sullivan. New York: John Wiley & Sons, Inc., 1996.
- *Intellectual Property Infringement Damages: A Litigation Support Handbook.* Russell L. Parr. New York: John Wiley & Sons, Inc., 1993.
- *Valuation of Intellectual Property and Intangible Assets.* Gordon Smith and Russell Parr. New York: John Wiley & Sons, Inc., 1994, 2nd Edition.
- *Valuation of Intellectual Property* videocourse. Joseph A. Agiato and Russell L. Parr. New York: The American Institute of Certified Public Accountants, Inc., 1996.
- *Valuation of Intellectual Property Course Handbook.* Joseph A. Agiato and Russell Parr. New York: AICPA Publication, 1996.
- *Investing in Tangible Assets: Finding and Profiting From Hidden Corporate Value.* Russell L. Parr. New York: John Wiley & Sons, Inc., 1991.
- *How to License Technology.* Robert C. Megantz. New York: John Wiley & Sons, Inc., 1996.
- *Licensing Intellectual Property: Legal, Business and Market Dynamics.* John W. Schlicher. New York: John Wiley & Sons, Inc., 1996.

Professional Organizations

Not only are there national professional organizations that provide information on intellectual property matters, but there are also a number of local organizations that serve similar functions. The more popular national organizations include the following:

- Licensing Executives Society
- American Intellectual Property Law Association
- Intellectual Property Owners
- International Intellectual Property Alliance
- International Intellectual Property Association

- National Association of Plant Patent Owners
- National Council of Intellectual Property Law Associations
- Patent and Trademark Office Society
- Trademark Society
- The International Trademark Association
- The Association of Collegiate Licensing Administrators

The specific functions of these professional organizations, as well as their addresses and telephone numbers, are summarized in appendix C of this practice aid. This source of this data is a publication entitled *National Trade and Professional Associations of the United States.*[1] This publication is issued by Columbia Books, Inc., and is updated yearly to incorporate any changes to existing listings or the addition of new organizations.

World Wide Web and Other Internet Sites

With the advent of the Internet, the World Wide Web (WWW) as well as other online interests, a number of sources have developed that are available to the appraiser to access market information relating to businesses and intellectual property matters. Although it is not possible to list all potential sources of information, the following represents some World Wide Web and other Internet sites that may prove useful to the appraiser:

- http://www.altavista.digital.com (search engine)
- http://www.hoovers.com (provides vast amounts of company data)
- http://www.sec.gov (provides the full text of the SEC *Daily Digest* and access to EDGAR, the SEC's searchable database of filings)
- http://plaza.interport.net/inta/tmresour.htm (access to the resource files of the International Trademark Association)
- http://www.whithouse.gov/wh/html/briefroom.html#fsbr (provides various government statistics)
- http://www.les.org (the Licensing Executives Society Web site)
- http://www.uspto.gov (searchable database of patent abstracts)
- http://www.loc.gov (offers access to the United States Copyright Office)
- http://www.ggmark.com (provides trademark information as well as links to other intellectual property Web sites)

[1] Author. The National Trade and Professional Associations of the United States. Washington, D.C.: Columbia Books, updated annually.

APPENDIX B

INTELLECTUAL PROPERTY PROFESSIONAL ASSOCIATIONS

Licensing Executives Society (1965)
1800 Diagonal Rd., Suite 280
Alexandria, VA
(703) 836-3106
Fax (703) 836-3107

American Intellectual Property Law Association (1897)
2001 Jefferson Davis Highway, Suite 203
Arlington, VA 22202
(703) 415-0780
Fax (703) 415-0786

Intellectual Property Owners (1972)
1255 23rd. Street NW, Suite 850
Washington, DC 20037
(202) 466-2396
Fax (202) 466-2893

International Intellectual Property Alliance (1984)
1747 Pennsylvania Avenue NW, 12th Floor
Washington, DC 30006
(202) 833-4198
Fax (202) 872-0586

International Intellectual Property Association (1930)
1255 223rd St. NW, Suite 850
Washington, DC 20037
(202) 785-1814
Fax (202) 466-2893

National Association of Plant Patent Owners (1939)
1250 1 St. NW, Suite 500
Washington, DC 20005
(202) 789-2900
Fax (202) 789-1893

National Council of Intellectual Property Law Associations (1934)
c/o Procter and Gamble
11520 Reed Hariman Hwy.
Cincinnati, OH 45241
(513) 634-4782

Patent and Trademark Office Society (1917)
P.O. Box 2089 East Station
Arlington, VA 22202

Trademark Society (1961)
P.O. Box 2631, East Station
Arlington, VA 22202
(703) 308-9112

International Trademark Association (1878)
1133 Avenue of the Americas
New York, NY 10036
(212) 768-9887
Fax (212) 768-7796

Association of Collegiate Licensing Administrators
638 Prospect Avenue
Hartford, CT 00105
(860) 586-7524
Fax (860) 586-7500

American Society of Composers, Authors and Publishers (1914)
(ASCAP)
1 Lincoln Plaza
New York, NY 10023
(212) 595-3050

Copyright Society of the USA (1953)
1133 Avenue of the Americas
New York, NY 10036
(212) 354-6401

Pacific Intellectual Property Association (1970)
P.O. Box 3477, Grand Central Station
New York, NY 10163

Software Publishers Association (1984)
1730 M Street NW, Suite 700
Washington, D.C. 20036-4510
(202) 452-1600

Patent Office Professional Association (5257)
P.O. Box 2745
Arlington, VA 22202
(703) 305-3000

Inventors Workshop International Education Foundation (1971)
7332 Mason Avenue
Canoga Park, CA 91306-2822

International Licensing Industry Merchandisers' Association (1983)
350 5th Avenue, Suite 6210
New York, NY 10118
(212) 244-1944

This is not an all-inclusive list.

Los Angeles Copyright Society (1952)
c/o Stephen A. Kroft
McDermott, Will and Emery
7049 Century Park, E. 34th Floor
Century City, CA 90067-3208
(310) 205-8373

Association of University Technology Managers (1974)
71 East Avenue, Suite 5
Norwalk, CT 06851
(203) 852-7168

Business Software Alliance (1988)
2001 L Street NW, Suite 400
Washington, D.C. 20036
(202) 872-5500

APPENDIX C

SUMMARY OF CASES CLASSIFIED BY INTANGIBLE ASSET

Case	Intangible Property
Comr. v. McCarthy, 129 F.2d 84 (7th Cir. 1942), 29 A.F.T.R. 786	Abandonment
***Massey-Ferguson, Inc.*, 59 T.C. 220 (1972), acq., 1973-1 C.B.1**	Abandonment
Northwestern Yeast Co., 5 B.T.A. 232 (1926), acq., VI-2 C.B. 6	Advertising costs
***Latendresse v. Comr.*, 243 F.2d 577 (7th Cir. 1957), 51 A.F.T.R. 145, cert. denied, 355 U.S. 830 (1957)**	Agency contracts
Marte Formico, 1971 P-H T.C. Memo Para. 71,171 (1971), aff'd, 491 F.2d 788 (9th Cir. 1974), 33 A.F.T.R. 2d 74-736	Agency contracts
Murphy Management Co. v. U.S., 302 F.Supp. 46 (D. Minn. 1969), 23 A.F.T.R. 2d 69-1633	Agency contracts
***Estate of Roberts v. Comr.*, 59 T.C. 128 (1972)**	Agency rights
Asch, T.C. Memo 1954-244	Agreements not to compete
***B.T. Babbitt, Inc. v. Comr.*, 32 B.T.A. 693 (1935), acq. 1935-2 C.B. 2**	Agreements not to compete
***Burke v. Comr.*, 18 T.C. 77 (1952)**	Agreements not to compete
***Dauksch v. Busey*, 125 F. Supp. 130 (S.D. Ohio 1954)**	Agreements not to compete
Herndon, T.C. Memo 1962-184	Agreements not to compete
J.S.L Restaurants, Inc., T.C. Memo Docket No., 23382- 2/28/51	Agreements not to compete
***Frances Silberman, et al., Petitioner v. Commissioner of Internal Revenue*, Respondent, 22 T.C. 1240**	Agreements not to compete
Standard Lumber & Hardware Co., T.C. Memo 1959-159	Agreements not to compete
***Walker v. Comr.*, T.C. Memo 1954-71**	Agreements not to compete
Wilson Athletic Goods Mfg. Co. v. Comr., 222 F. 2d 355 (7th Cir. 1955)	Agreements not to compete
***Sexton v. Comr.*, 42 T.C. 1094 (1964)**	Air space
Faura v. Comr., 73 T.C. 849 (1980)	Author's expenses
Garrison v. Comr., 86 T.C. 764 (1986)	Author's expenses
Hadley v. Comr., 819 F.2d 359 (2d Cir. 1987)	Author's expenses
Banc One Corp. v. Comr., 85 T.C. 476 (1985)	Bank Core deposits
Midatlantic Nat'l Bank v. Comr., T.C. Memo 1983-581	Bank Core deposits
Southern Bancorporation v. U.S., 732 F.2d 374 (4th Cir. 1984)	Bank Core deposits
Southern Bancorporation, Inc. v. Comr., 847 F.2d 131 (4th Cir. 1988)	Bank Core deposits
Joel Sharon, 66 T.C. 515 (1976), aff'd, 591 F.2d 1273 (9th Cir. 1978), 43 A.F.T.R. 2d 79-335	Bar exam fees
Atchison, Topeka and Santa Fe R.R. Co. v. U.S., 443 F.2d 147 (10th Cir. 1971), 27 A.F.T.R. 2d 71-1587, no. cert. (G), 1971 P-H Para. 61,000	Bond discount on reorganization
***National Alfalfa Dehydrating & Milling Co. v. Comr.*, 57 T.C. 46, rev'd, 472 F.2d 796, 31 A.F.T.R. 2d 73-678 (10th Cir. 1973), rev'd, 417 U.S. 134 (1974)**	Bond discount on reorganization
***Dean v. Comr.*, 83 T.C. 56 (1984)**	Book rights
***Fuchs v. Comr.*, 83 T.C. 79 (1984)**	Book rights

Case	Intangible Property
***Leger v. Comr.*, 53 T.C.M. 384 (1987)**	Book rights
***Webster Investors Inc. v. Comr.*, 19 T.C.M. 396 (1960), aff'd 291 F.2d 192 (2d Cir. 1961)**	Brand name
***KWTX Broadcasting Co. v. Comr.*, 31 T.C. 952 (1959), aff'd percuriam, 272 F.2d 406 (5th Cir. 1959)**	Broadcasting license
Richmond Television Corp. v. U.S., 354 F.2d 410 (4th Cir. 1965)	Broadcasting license
***Times-World Corp. v. U.S.*, 251 F. Supp. 43 (W.D. Va. 1966)**	Broadcasting license
WDEF Broadcasting Co. v. U.S., 215 F. Supp. 818 (E.D. Tenn. 1963)	Broadcasting license
Shannon F. Hollingsworth, 42 P-H T.C. Memo Para. 73,179 (1973)	Brokerage accounts
***Mid-State Products Co. v. Comr.*, 21 T.C. 696 (1954)**	Business expansion costs
Blackett, T.C. Memo Docket No. 25689 9/28/51	Business licenses and franchises
***D.J. Campbell Co., Inc. v. U.S.*, 370 F.2d 336 (Ct. Cl. 1966)**	Business licenses and franchises
***Nachman v. Comr.*, 12 T.C. 1204(A) (1949)**	Business licenses and franchises
Finoli v. Comr., 86 T.C. 697 (1986)	Cable TV subscriber contract
Briarcliff Candy Corp. v. Comr., 475 F.2d 775 (1973)	Capitalized business expenses
Ellis Banking Corp., 1981 P-H T.C. Memo Para. 81, 123, rem'd, 688 F.2d 1376 (11th Cir. 1982), 50 A.F.T.R. 2d 82-5908	Capitalized business expenses
Liquid Paper Corp. v. U.S., 83-1 USTC 9305 (Ct. Cl. 1983)	Capitalized business expenses
M.L. Eakes Co., Inc., 1981 P-H T.C. Memo para. 81,429, aff'd, 686 F.2d 217 (4th Cir. 1982), 50 A.F.T.R. 2d 82-5582	Capitalized business expenses
NCNB Corp. v. U.S., 684 F.2d 285 (4th Cir. 1982)	Capitalized business expenses
Computing & Software, Inc., 64 T.C. 223 (1975), further proceeding, 65 T.C. 1153 (1976)	Collection accounts and customer structure
***Credit Bureau of Erie, Inc.*, 54 T.C. 726 (1970)**	Collection accounts and customer structure
Bank of Vermont v. U.S., 88-1 USTC 9169 (D. Vt. 1988)	Computer software
Golden v. Comr., T.C. Memo 1989-514	Computer software
Hahn v. Comr., T.C. Memo 1990-43	Computer software
Kretschmer v. Comr., T.C. Memo 1989-242	Computer software
Ronnen v. Comr., 90 T.C. 74 (1988)	Computer software
Vaaler Ins. Inc. v. U.S., 68-1 USTC ¶9183 (N.D. 1968)	Contract lists
***Ambrose v. Comr.*, 15 T.C.M. 643 (1956)**	Contract rights
Curry v. U.S., 298 F.2d 273 (4th Cir. 1962), 9 A.F.T.R. 2d 497	Contract rights
***Donehoo v. U.S.*, 68-1 U.S.T.C. ¶12,519 (W.D. Pa. 1968)**	Contract rights
***Estate of Curry v. Comr.*, 74 T.C. 540 (1980)**	Contract rights
***Estate of Pascal v. Comr.*, 22 T.C.M. 1766 (1963)**	Contract rights
***Galt v. Comr.*, 19 T.C. 892 (1953), aff'd in part, rev'd in part, 216 F.2d 41 (7th Cir. 1954), cert. denied, 348 U.S. 951 (1955)**	Contract rights
***Grill v. U.S.*, 62-2 U.S.T.C. ¶9537 (1962)**	Contract rights
***Pine State By-Products, Inc. v. Comr.*, 32 T.C.M. 665 (1973)**	Contract rights
Reserve Natural Gas Co. of La., 12 B.T.A. 219 (1928), acq., VII-2 C.B. 33	Contract rights
***Atlantic Carton Corp. v. Comr.*, 2 B.T.A. 380 (B.T.A. 1925)**	Contracts
City Ice Delivery Co. v. U.S., 176 F.2d 347 (4th Cir. 1949), 38 A.F.T.R. 331	Contracts
Foy. v. Comr., 84 T.C. 50 (1985)	Contracts

This is not an all-inclusive list.

Case	Intangible Property
***Imperial News Co., Inc. v. U.S.*, 576 F.Supp. 865 (E.D.N.Y. 1983)**	Contracts
Pennsylvania Salt Mfg. Co., 18 B.T.A. 1148 (1930), acq., IX-2 C.B. 47	Contracts
The Birmingham News Co. v. Patterson, 345 F.2d 531 (5th Cir. 1965), 15 A.F.T.R. 2d 1079, no cert. (G), 1965 P-H Para. 56, 467	Contracts
***Western Valve Bag Co. v. Comr.*, 13 B.T.A. 749 (B.T.A. 1928)**	Contracts
***Apple Computer, Inc. v. Franklin Computer Corp.*, 714 F.2d 1240 (3d Cir. 1983), cert. dismissed, 464 U.S. 1033 (1984)**	Copyright
***Associated Obstetricians & Gynecologists, P.C. v. Comr.*, 762 F.2d 38 (6th Cir. 1985)**	Copyright
***Associated Patentees, Inc. v. Comr.*, 4 T.C. 979 (1945)**	Copyright
Broderbund Software, Inc. v. Unison World, Inc., 648 F.Supp. 1127 (N.D. Cal. 1986)	Copyright
John R. Thompson Co. v. Comm'r., 477 F.2d 164 (7th Cir. 1973)	Copyright
Newton Insert Co. v. Comm'r., 61 T.C. 570 (1974), aff'd per curiam, 545 F.2d 1259 (9th Cir. 1976)	Copyright
Whelan Assoc., Inc. v. Jaslow Dental Lab. Inc., 797 F.2d 1222 (3d Cir. 1986)	Copyright
***Borg & Beck Co. v. Comr.*, 24 B.T.A 995 (A) (B.T.A. 1931)**	Copyright and patent
***Hershey Mfg. Co. v. Comr.*, 14 B.T.A 867 (NA) (B.T.A. 1928), aff'd 43 F.2d 298 (10th Cir. 1930)**	Copyright and patent
***Hyatt Roller Bearing Co. v. U.S.*, 43 F.2d 1008 (Ct. Cl. 1930)**	Copyright and patent
***Sarkes Tarzian, Inc. v. U.S.*, 140 F.Supp. 863 rev'd and rem'd on other issue 240 F.2d 467 (7th Cir. 1957) or remand 159 F.Supp. 253 (S.D. Ind. 1958)**	Copyright and patent
***Service Recorder Co. v. Routzahn* 24 F. 2d 875 (D.C. Ohio, 1927)**	Copyright and patent
National Starch and Chemical Corp. v. Comr., 918 F.2d 426 (3d Cir. 1990)	Corporate reorganization expenses
Wade Snell, Jr., 1979 P-H T.C. Memo Para. 79,141	Cost of becoming an underwriter
Lowell H. Wilson, 1982 P-H T.C. Memo Para. 82,131	Costs to attempt irrigation of non-percolable land
ABCO Oil Corp. v. Comr., T.C. Memo 1990-40	Covenant not to compete
***Annabelle Candy Co. v. Comr.*, 314 F.2d 1 (9th Cir. 1962)**	Covenant not to compete
Balthrope v. Comr., 356 F.2d 28 (5th Cir. 1966), 17 A.F.T.R. 2d 173	Covenant not to compete
Barnes Group, Inc. v. U.S., 724 F. Supp. 37 (D. Conn. 1989), aff'd per curiam, 902 F.2d 1114 (2d Cir. 1990)	Covenant not to compete
Better Beverages, Inc. v. U.S., 44 A.F.T.R. 2d 79-5101 (S.D. Tex. 1978), aff'd, 619 F.2d 424 (5th Cir. 1980), 46 A.F.T.R. 2d 90-5219	Covenant not to compete
Bradley v. U.S., 730 F.2d 718 (11th Cir. 1984)	Covenant not to compete
***Comr. v. Gazette Tel. Co.*, 209 F.2d 926 (10th Cir. 1954), 45 A.F.T.R. 266**	Covenant not to compete
Critz v. Comr., T.C. Memo 1987 -538	Covenant not to compete
Danielson v. Comr., 44 T.C. 549 (1965), rev'd, 378 F.2d 771 (3d Cir. 1967), cert. denied, 389 U.S. 858 (1967)	Covenant not to compete

Case	Intangible Property
Dixie Finance Co., Inc. v. Comr., 474 F.2d 501 (5th Cir. 1973)	Covenant not to compete
Elrod v. Comr., 87 T.C. 1046 (1986)	Covenant not to compete
Feifer v. U.S., 80-2 U.S.T.C. ¶9729	Covenant not to compete
***Feller v. Comr.*, 45 T.C.M. 902 (1983)**	Covenant not to compete
***Fidler v. Comr.*, 40 T.C.M. 1080 (1980)**	Covenant not to compete
***Forward Communications Corp. v. U.S.*, 221 Ct. Cl. 582, 608 F. 2d 485, 79-2 USTC P 9638 (Ct. Cl. 1979)**	Covenant not to compete
Franks v. Comr., T.C. Memo 1988-245	Covenant not to compete
Furman v. U.S., 602 F.Supp. 444 (D. S.C. 1984)	Covenant not to compete
General Insurance Agency, Inc. v. Comr., 17 B.T.A. 1213 (1929)	Covenant not to compete
Golden State Towel and Lines Service, Ltd. v. U.S., 373 F.2d 938 (Ct. Cl. 1967)	Covenant not to compete
Goldstein v. Comr., T.C. Memo 1984-62	Covenant not to compete
Golsen v. Comr., 54 T.C. 742 (1970); aff'd, 445 F.2d 985 (10th Cir. 1971); cert. denied, 404 U.S. 940 (1971)	Covenant not to compete
***Goodman v. U.S.*, 512 F. Supp. 155 (E.D. Mich. 1981), aff'd 708 F.2d 723 (6th Cir. 1982)**	Covenant not to compete
Grant Rudie, 49 T.C. 131 (1967), acq., 1968-1 C.B. 2	Covenant not to compete
Grow v. Comr., T.C. Memo 1984-64	Covenant not to compete
Hammett v. Comr., T.C. Memo 1987-205	Covenant not to compete
Herbert Emmer, 1978 P-H T.C. Memo Para. 78,102, appeal dismissed, 1978 P-H 61,000 (2d Cir.)	Covenant not to compete
Holman Distributors, Inc. v. Comr., T.C. Memo 1987 - 129	Covenant not to compete
Illinois Cereal Mills, Inc. v. Comr., T.C. Memo 1983-469, aff'd, 789 F.2d 1234 (7th Cir. 1986), cert. denied, 479 U.S. 995 (1986)	Covenant not to compete
Illinois Power Co. v. Comr., 87 T.C. 1417 (1986)	Covenant not to compete
Import Specialties, Inc., 1982 P-H T.C. Memo Para, 82-041	Covenant not to compete
Iron Range Plastics, Inc. v. U.S., 49 A.F.T.R. 2d 82-612 (D. Minn. 1981)	Covenant not to compete
Jacques Wallach, 1982 P-H T.C. Memo Para. 82, 502	Covenant not to compete
John Sadler, 1980 P-H T.C. Memo Para. 80,542 (1980), aff'd, ct. order 3-17-82 (9th Cir.)	Covenant not to compete
Kalamazoo Oil Co., 1982 P-H T.C. Memo Para. 81,344, aff'd, 693 F.2d 618 (6th Cir. 1982), 50 A.F.T.R. 2d 82-6109	Covenant not to compete
Kreider v. Comr., 762 F.2d 580 (7th Cir. 1985)	Covenant not to compete
***Krug v. Comr.*, 42 T.C.M. 1114 (1981)**	Covenant not to compete
Lazisky v. Comr., 72 T.C. 495 (1979) aff'd, 636 F.2d 11 (1st Cir. 1981)	Covenant not to compete
Leslie S. Ray Insurance Agency, Inc. v. Comr., 436 F. 2d 210 (1st Cir. 1972)	Covenant not to compete
Major v. Comr., 76 T.C. 239 (1981)	Covenant not to compete
***Markham & Brown, Inc. v. U.S.*, 648 F 2d 1043, 81-2 USTC P 9518 (5th Cir. (Tex.), 1981)**	Covenant not to compete
Maryland Nat'l Bank, 1974 P-H T.C. Memo para. 74, 209, aff'd, 38 A.F.T.R. 2d 76-5103 (4th Cir. 1976)	Covenant not to compete
Max J. Epstein, 33 P-H T.C. Memo Para. 64,192 (1964), appeal dismissed, 1965 P-H Para. 56,360 (2d Cir.)	Covenant not to compete
Michaels v. Comr., 12 T.C. 17 (1949), acq., 1949-1 C.B. 3	Covenant not to compete

This is not an all-inclusive list.

Case	Intangible Property
Molasky v. Comr., 897 F.2d 334 (8th Cir. 1990)	Covenant not to compete
Morton F. McKinney, 1978 P-H T.C. Memo Para. 78,448	Covenant not to compete
***Numa Co. v. Comr.*, 41 T.C.M. 887 (1981)**	Covenant not to compete
Numa Co., Ltd., 1981 P-H T.C. Memo Para. 81-063	Covenant not to compete
O'Dell and Co., 61 T.C. 461 (1974), acq., 1974-2 C.B. 3	Covenant not to compete
Patterson v. Comr., 810 F.2d 562 (6th Cir. 1987)	Covenant not to compete
***Peterson Machine Tool, Inc. v. Comr.*, 84-2 U.S.T.C. 9885 (10th Cir. 1984)**	Covenant not to compete
***Schutz v. Comr.*, 294 F.2d (9th Cir. 1961)**	Covenant not to compete
Servicemaster of Memphis v. U.S., 34 A.F.T.R. 2d 74-5557 (W.D. Tenn. 1974)	Covenant not to compete
Shilia D. MacDonald, 1982 P-H T.C. Memo Para 82,270	Covenant not to compete
Spector v. Comr., 641 F.2d 376 (5th Cir. 1981)	Covenant not to compete
***Stryker Corporation*, 44 T.C.M. 1020 (1982)**	Covenant not to compete
Theophelis v. U.S., 751 F.2d 165 (6th Cir. 1984)	Covenant not to compete
***Ullman v. C.I.R.*, 264 F. 2d 305, 59-1 USTC P 9314 (2nd Cir., 1959)**	Covenant not to compete
Valley Broadcasting Co., 1974 P-H T.C. Memo Para. 74,247 (1974)	Covenant not to compete
Van Landingham v. Comr., T.C. Memo 1987-66, cert. denied, 487 U.S. 1237 (1988)	Covenant not to compete
Visador Co., 1973 P-H T.C. Memo Para. 73,173, aff'd, 508 F.2d 816 (5th Cir. 1975), 35 A.F.T.R. 2d 75-816, no cert. (G), 1975 P-H Para. 61.000	Covenant not to compete
Warsaw Photographic Assoc., Inc. v. Comr., 84 T.C. 21 (1985)	Covenant not to compete
Colorado Springs Nat'l Bank v. U.S., 32 A.F.T.R. 2d 73-6175 (D. Colo. 1973), aff'd, 505 F.2d 1185 (10th Cir. 1974), 34 A.F.T.R. 2d 74-6166	Credit and membership fees
Anchor Cleaning Service, Inc., 22 T.C. 1029 (1954)	Customer list
Charleston v. Comr., T.C. Memo 1986-372	Customer list
Digital Communications Assoc., Inc. v. Softklone Distributing Corp., 659 F.Supp. 449 (N.D. Ga.1987)	Customer list
Disabled American Veterans v. Comr., 94 T.C. 60 (1990)	Customer list
Holden Fuel Oil Co., T.C. Memo 1972-45	Customer list
Los Angeles Central Animal Hospital, Inc. v. Comr., 68 T.C. 269 (1977), acq., 1978-1 C.B. 2	Customer list
***Manhattan Company of Virginia, Inc. v. Comr.*, 50 T.C. 78 (1968), acq., 1974-2 C.B. 3**	Customer list
Misegades, Keith v. Comr., 53 T.C. 477 (1969)	Customer list
Newark Morning Ledger Co. v. U.S., 734 F. Supp. 176 (D.N.J. 1990)	Customer list
Oxford Life Insurance Co. v. U.S., 790 F.2d 1370 (9th Cir. 1986)	Customer list
***Paine, Webber, Jackson & Curtis, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 564 F. Supp. 1358 (D. Del. 1983)**	Customer list
Panichi v. U.S., 834 F.2d 300 (2d Cir. 1987)	Customer list
Sirovatka v. Comr., T.C. Memo 1983-634	Customer list
Thoms v. Comr., 50 T.C. 247 (1968)	Customer list
***Wallis Tractor Co. v. Comr.*, 3 B.T.A 981 (A) (B.T.A. 1926)**	Drawings

Case	Intangible Property
Kentucky Utilities Co. v. Glenn, 250 F. Supp. 265 (W.D. Ky. 1965), aff'd in part and rev'd in part, 394 F.2d 631 (6th Cir. 1968)	Easements
Northern Natural Gas Co. v. O'Malley, 277 F.2d 128 (8th Cir. 1960)	Easements
Southern Natural Gas Co. v. U.S., 412 F.2d 1222 (Ct. Cl. 1969), 23 A.F.T.R. 2d 69-1714, disagreed on other issue, *Idaho Power Co. v Comr.*, 477 F.2d 688 (9th Cir. 1973), 31 A.F.T.R. 2d 73-1148, rev'd on other issues, 418 U.S. 1 (1974)	Easements
W.R. Knapp, 1977 P-H T.C. Memo Para. 77,389	Easements
Badger Pipe Line Co. v. U.S., 401 F.2d 799 (Ct. Cl. 1968)	Easements, pipeline
***Commonwealth Natural Gas Corp. v. U.S.*, 195 F.2d 493 (D. Va. 1966)**	Easements, pipeline
***Panhandle Eastern PipeLine Co. v. U.S.*, 408 F.2d 690 (Ct. Cl. 1969)**	Easements, pipeline
Shell Pipeline Corp. v. U.S., 267 F.Supp. 1014 (S.D. Tex. 1967)	Easements, pipeline
***Tenneco, Inc. v. U.S.*, 433 F.2d 1345 (5th Cir. 1970)**	Easements, pipeline
Texas-New Mexico Pipeline Co. v. U.S., 401 F.2d 796 (Ct. Cl. 1968)	Easements, pipeline
***Cummins v. C.I.R.*, 217 F. 2d 303, 54-2 USTC P 9698 (2nd Cir., 1954)**	Exchange memberships
Coca Cola Bottling Co., 6 B.T.A. 1333 (1927)	Exclusive right to market a given area
***Bender v. U.S.*, 383 F.2d 656 (6th Cir. 1967), 20 A.F.T.R. 2d 5521, cert. denied, 390 U.S. 958 (1968)**	Expenditure to secure a lease
Marsh and McLennan, Inc. v. Comr., 51 T.C. 56 (1968), aff'd, 420 F.2d 667 (3d Cir. 1969)	Expiration lists
Miller, Richard S., & Sons, Inc. v. Comr., 537 F.2d 446 (Ct. Cl. 1976)	Expiration lists
Robert Rost v. U.S., 371 F. Supp. 670 (D. Tex. 1973), 33 A.F.T.R. 2d 74-411	Expiration lists
Robert Tomlinson, 58 T.C. 570 (1972), aff'd, 507 F.2d 723 (9th Cir. 1974), 35 A.F.T.R. 2d 75-423	Expiration lists
Robins & Weill, Inc. v. U.S., 382 F.Supp. 1207 (M.D. N.C. 1974)	Expiration lists
Waldo E. Stewart, 372 F. Supp. 407 (N.D. Tex. 1974), 33 A.F.T.R. 2d 74-760	Expiration lists
***Equitable Pub. Co. v. C.I.R.*, 356 F. 2d 514, 66-1 USTC P 9298 (3rd Cir., Mar 08, 1996)**	FCC license
Meredith Broadcasting Co. v. U.S., 405 F.2d 1214 (Ct. Cl. 1968)	FCC license
Chase Candy Co. v. U.S., 126 F.Supp. 521 (Ct. Cl. 1954), 46 A.F.T.R. 1319	Federal ration allotments
***Abramson v. Comr.*, 53 T.C.M. 985 (1987)**	Film rights
Bailey v. Comr., 90 T.C. 558 (1988)	Film rights
***Barkley v. C.I.R.*, 878 F. 2d 1438 (9th Cir., 1989)**	Film rights
***Bass v. Comr.*, 55 T.C.M. 126 (1988)**	Film rights
***Brawner v. Comr.*, 54 T.C.M. 1147 (1987)**	Film rights
Brown v. Comr., T.C. Memo 1988-527	Film rights
Durkin v. Comr., 87 T.C. 1329 (1986)	Film rights

This is not an all-inclusive list.

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***Gilmartin v. Comr.*, 47 T.C.M. 1532 (1984)**	Film rights
***Harrington v. Comr.*, 48 T.C.M. 837 (1984), aff'd, 774 F.2d 1151 (3d Cir. 1985)**	Film rights
Inter-City T.V. Film Corp., 43 T.C. 270 (1964)	Film rights
Kiro, Inc. v. Comr., 51 T.C. 155 (1968), acq. in result, 1974-2 C.B. 3	Film rights
Law v. Comr., 86 T.C. 1065 (1986)	Film rights
Markin v. Comr., T.C. Memo 1989-665	Film rights
***Proesel v. Comr.*, 77 T.C. 992 (1981)**	Film rights
***Springfield Productions, Inc. v. Comr.*, 38 T.C.M. 74 (1979)**	Film rights
Tolwinsky v. Comr., 86 T.C. 1009 (1986)	Film rights
Upham v. Comr., T.C. Memo 1989-253	Film rights
Wildman, 78 T.C. 943 (1982)	Film rights
***Bolton v. Comr.*, 82-2 USTC ¶9699, 694 F.2d 556 (9th Cir. 1981)**	Franchise
***Bowman v. Comr.*, 54 T.C.M. 975 (1987)**	Franchise
Business Service Industries, Inc. v. Comr., T.C. memo 1986-86	Franchise
Cleveland Railway Co., 36 B.T.A. 208 (1937), acq., 1937-2 C.,B. 5	Franchise
***Conde Nast Publications, Inc. v. U.S.* 575 F. 2d 400 78-1 USTC P 9408, 198 U.S.P.Q. 202**	Franchise
***Consolidated Foods Corp. v. U.S.*, 78-1 USTC ¶9180, 569 F.2d 436 (7th Cir. 1978)**	Franchise
***Dairy Queen of Okl., Inc. v. C.I.R.*, 250 F. 2d 503 58-1 USTC P 9155**	Franchise
Dunn v. U.S., 400 F.2d 679 (10th Cir. 1968), 22 A.F.T.R. 2d 5653	Franchise
***Estate of Gowdey v. Comr.*, 62-2 USTC ¶9603, 307 F.2d 816, 819 (4th Cir. 1962)**	Franchise
Estate of John C. Burns, 1947 P-H T.C. Memo Para. 47,242	Franchise
***Grace Dobson v. U.S.*, 51 A.F.T.R. 2d 83-363 (Ct. Cl. 1982)**	Franchise
Gulf Television Corp. v. Comr. 52 T.C. 1038 (1969)	Franchise
***Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368, 387 (5th Cir. 1977)**	Franchise
***Moberg v. Comr.*, 62-2 USTC ¶9662, 305 F.2d 800, 806 (5th Cir. 1962) rev'g and rem'g CCH Dec. 24, 677, 35 T.C. 773 (1961)**	Franchise
***Moore v. Comr.*, 70-1 USTC ¶9393, 425 F.2d 713, 714 (9th Cir. 1970)**	Franchise
***Morse-Starrett Products Co. v. Steccone*, 86 F. Supp. 796, 805 (N.D. Cal. 1949)**	Franchise
***Mountcastle v. U.S.*, 226 F. Supp. 706, 64-1 USTC P 9190 (M.D. Tenn., 1963)**	Franchise
***Resorts International, Inc. v. Comr.*, 75-1 USTC ¶9405, 511 F.2d 107 (5th Cir. 1975)**	Franchise
Rodeway Inns of America, 63 T.C. 414 (1974), acq., 1975-1 C.B. 2	Franchise
Super Food Services, Inc. v. U.S., 416 F.2d 1236 (7th Cir. 1969), 24 A.F.T.R. 2d 69-5309	Franchise
***Susser v. Carvel Corp.*, 206 F.2d 505 (2d Cir. 1964)**	Franchise
Tomerlin Trust v. Comr., CCH Dec. 43, 466, 87 T.C. 876, 896 n.7 (1986)	Franchise
***U.S. v. Wernentin*, 354 F. 2d 757, 66-1 USTC P 9140 (8th Cir. (Iowa), 1965)**	Franchise

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W.K. Company v. C.I.R., 478 F. 2d 1404 (7th Cir., 1973)	Franchise
Waddell v. Comr., 86 T.C. 848 (1986)	Franchise
Zorniger v. Comr., 62 T.C. 435 (1974), acq. in result, 1975-1 C.B. 2	Franchise
Akers v. Comr., CCH Dec. 15,073, 6 T.C. 693 (1946), acq., 1976-2 CB 1	Franchise goodwill
***Arnott v. American Oil Co.*, 609 F.2d 873, 882 (8th Cir. 1979), cert. denied, 446 U.S. 918 (1980)**	Franchise goodwill
Automatic Heating and Cooling Co. v. Comr., CCH Dec. 12,864-B, 42 B.T.A Memo (P-H) 1449, 1453 B.T.A. Memo (Oct. 20, 1942)	Franchise goodwill
City of Omaha v. Omaha Water Co., 218 U.S. 180, 202 (1910)	Franchise goodwill
Mittelman v. Comr., CCH Dec. 15,474, 7 T.C. 1162,1170 (1946)	Franchise goodwill
***Montgomery Coca-Cola Bottling Co., Inc. v. U.S.*, 222 Ct. Cl. 356, 615 F. 2d 1318, 80-1 USTC P 9230 (Ct. Cl., 1980)**	Franchise goodwill
Pasadena City Lines, Inc. v. Comr., CCH Dec. 20,606, 23 T.C. 34 (1954) acq., 1955-1 CB 6	Franchise goodwill
Herrick v. Comr., 85 T.C. 237 (1985)	Franchises/trademark/trade names
Jackson v. Comr., 86 T.C. 492, 513 (1986)	Franchises/trademark/trade names
Renziehausen v. Lucas, 280 U.S. 387 (1930)	Franchises/trademark/trade names
***Tele-Communications, Inc. v. Comr.*, 95 T.C. No. 36 (1990)**	Franchises/trademark/trade names
McAlpin v. U.S., 82-2 U.S.T.C. ¶13,490	Gas royalty interests
Northern Natural Gas Co. v. U.S., 470 F.2d 1107 (8th Cir. 1973), 31 A.F.T.R. 2d 73-492, cert. denied, 412 U.S. 939 (1973)	Going-concern value
***U.S. v. Cornish*, 348 F. 2d 175, 65-2 USTC P 9508 (9th Cir. (Or.), 1965)**	Going-concern value
UFE, Inc. v. Comr., 92 T.C. 1314 (1989)	Going-concern value
VGS Corp. v. Comr., 68 T.C. 563 (1977)	Going-concern value
Concord Control, Inc. v. Comr., 35 T.C.M. 1345 (1976), aff'd and rem'd, 615 F.2d 1153 (6th Cir. 1980), on remand, 78 T.C. 742 (1982), acq., 1984-2 C.B. 1	Goodwill
Copperhead Coal Co., Inc., 1958 P-H T.C. Memo Para. 58,000, aff'd, 272 F.2d 45 (6th Cir. 1950), 4 A.F.T.R. 2d 5908	Goodwill
Curtis-Noll Corp., 1982 P.H. T.C. Memo Para. 82,363	Goodwill
Durovic v. Comr., 65 T.C. 480 (1975)	Goodwill
***Edison International, Inc. v. U.S.*, 86-2 U.S.T.C. ¶9525 (Ct. Cl. 1986)**	Goodwill
Estate of Henry Maddock, 16 T.C. 324 (1951)	Goodwill
***Haberle Crystal Springs Brewing Co. v. Clarke*, 280 U.S. 384 (1930), 8 A.F.T.R 10267**	Goodwill
***Import Specialties, Inc. v. Comr.*, 43 T.C.M. 411 (1982)**	Goodwill
Killian, Comr. v., 314 F.2d 852 (5th Cir. 1963)	Goodwill
Metropolitan Bank v. St. Louis Dispatch Co., 149 U.S. 436 (1893)	Goodwill
***Mule v. Comr.*, 45 T.C.M. 1420 (1983)**	Goodwill
Nelson Weaver Realty Co. v. Comr., 307 F.2d 897 (5th Cir. 1962)	Goodwill
***Procter v. Comr.*, 42 T.C.M. 725 (1981)**	Goodwill
R.M. Smith, 1977 P-H T.C. Memo Para. 77,023, further proceeding, 69 T.C. 317 (1977)	Goodwill
***Red Wing Malting Co. v. Willcuts*, 15 F.2d 626 (8th Cir. 1926)**	Goodwill

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***Seaboard Automotive, Inc. v. Comr.*, 42 T.C.M. 529 (1981)**	Goodwill
Solitron Devices, Inc., 80 T.C. No.1 (1983)	Goodwill
W.F. Glisson, 1981 P-H T.C. Memo Para. 81,379	Goodwill
***Wallach v. Comr.*, 44 T.C.M. 1002 (1982)**	Goodwill
***X-Pando Corp. v. Comr.*, 7 T.C. 48 (1946), app. dism'd (CCA-2) 2/7/48**	Goodwill
Zeropack Company v. Comr., T.C. Memo 1983-652	Goodwill
Shufflebarger v. Comr., 24 T.C. 980 (1955)	Grazing rights
Shutler v. U.S., 470 F.2d 1143 (10th Cir. 1972)	Grazing rights
Uecker v. Comr., 81 T.C. 983 (1983), aff'd, 766 F.2d 909 (5th Cir. 1985)	Grazing rights
Glenn Heigerick, 45 T.C. 475 (1966)	Hospital staff privileges
S.M. Howard, 39 T.C. 833 (1963)	Hospital staff privileges
***Wells-Lee v. C.I.R.*, 360 F. 2d 665, 66-1 USTC P 9405 (8th Cir.) (Mo.), 1966)**	Hospital staff privileges
***Blaine, v. U.S.*, 41 F. 2d 917, 71-1 USTC P 9373 (5th Cir. (Tex.), 1971)**	Insurance expiration lists
Decker v. Comr., 864 F.2d 51 (7th Cir. 1988)	Insurance expiration lists
Morris, T.C. Memo 1968-295	Insurance expiration lists
***S.S. Ballin Agency, Inc. v. Comr.*, 446 F.2d 554 (3d Cir. 1971), aff'g T.C. Memo 1969-203**	Insurance expiration lists
***Salome, Jr. v. U.S.*, 395 F.2d 990 (5th Cir. 1968), aff'g 67-2 U.S.T.C. p. 9609 (W.D. Tex. 1967)**	Insurance expiration lists
Savings Assurance Agency, Inc., T.C. Memo 1963-52	Insurance expiration lists
***Squires v. U.S.*, 289 F. Supp. 597 68-2 USTC P 9531 (C.D. Cal., 1968)**	Insurance expiration lists
Commercial Nat'l Ins. Co., 12 B.T.A. 655 (1928)	Insurance in force
Kentucky Central Life Insurance Co. v. Comr., 57 T.C. 482 (1972), acq., 1972-2 C.B. 2	Insurance in force
***Southwestern Life Ins. Co.*, 560 F.2d 627 (5th Cir. 1977), cert. denied 435 U.S. 995 (1978)**	Insurance in force
***Union Bankers Insurance Co. v. Comr.*, 64 T.C. 807 (1975), acq., 1976-2 C.B. 3**	Insurance in force
212 Corp. v. Comr., 70 T.C. 788 (1978)	Intangible
Abramson v. Comr., 86 T.C. 360 (1986)	Intangible
Albany Car Wheel Co., Inc. v. Comr., 333 F.2d 653 (2d Cir. 1964)	Intangible
Black Industries, Inc. v. Comr., T.C. Memo 1979-61	Intangible
Coleman v. Comr., 87 T.C. 178 (1986), aff'd 833 F.2d 303 (3d Cir. 1987) (without pub. opin.)	Intangible
***Comr. v. Ferrer*, 62-2 USTC ¶9518, 304 F.2d 125,135 (2d Cir. 1962)**	Intangible
***Comr. v. Tufts*, 461 U.S. 300 (1983)**	Intangible
Fedders Corporation, 39 T.C.M. 1	Intangible
Fong v. Comr., T.C. Memo 1984-402	Intangible
Frank Lyon Co. v. U.S., 435 U.S. 561 (1978)	Intangible
Franklin Est. v. Comr., 544 F.2d 1045 (9th Cir. 1976)	Intangible
General Television, Inc., 79-1 U.S.T.C. ¶9136	Intangible
Gibson v. Comr., 88 T.C. 38 (1987)	Intangible

Case	Intangible Property
Greene v. Comr., 81 T.C. 132 (1983)	Intangible
Hillsboro Nat'l Bank v. Comr., 460 U.S. 370 (1983)	Intangible
Houston Natural Gas Corp. v. Comr., 90 F.2d 814 (4th Cir. 1973), cert. denied, 302 U.S. 722 (1937)	Intangible
Joe Kelley Butler, Inc. v. Comr., 87 T.C. 734 (1987)	Intangible
***Jostens, Inc.*, 58 T.C.M. 933 (1989)**	Intangible
Massey Motors, Inc. v. U.S., 364 U.S. 92 (1960)	Intangible
Niagara Mohawk Power Corp. v. U.S., 525 F.2d 1380 (Ct. Cl. 1975)	Intangible
Producer's Grain & Gin Co., Inc. v. Comr., T.C. Memo 1987-370	Intangible
R.M. Smith, Inc. v. Comr., 591 F.2d 248 (3d Cir. 1979)	Intangible
Schneider v. Comr., 65 T.C. 18 (1975)	Intangible
Taggart, Inc. v. U.S., 744 F.2d 442 (5th Cir. 1984)	Intangible
Thor Power Tool Co. v. Comr., 439 U.S. 522 (1979)	Intangible
***Thrifticheck Service Corp. v. Comr.*, 33 T.C. 1038 (1960), aff'd, 287 F.2d 1 (2d Cir. 1961)**	Intangible
***U.S. v. Cartwright*, 411 U.S. 546 (1973)**	Intangible
***U.S. v. Skelly Oil Co.*, 394 U.S. 678 (1969)**	Intangible
WEG Dial Telephone, Inc. v. Comr., T.C. Memo 1966-41	Intangible
Welch v. Helvering, 290 U.S. 111 (1933)	Intangible
***Williams v. McGowan* , 152 F.2d 570 (2d Cir. 1945)**	Intangible
Winn-Dixie Montgomery, Inc. v. Comr., 307 F. Supp. 1304 (W.D. Ala. 1970), aff'd, 444 F.2d 677 (5th Cir. 1971)	Intangible
Gulf Power Co., 10 T.C. 852 (1948)	Integration value
***1620 Broadway Corp.*, 36 B.T.A. 149 (1937), acq., 1937-2 C.B. 25**	Leaseholds
Action Distributing Co., Inc. v. Comr., T.C. Memo 1987-377	Leaseholds
Aiken Drive-In Theatre Corp., 25 P-H T.C. Memo Para. 56,136 (1956), aff'd, 281 F.2d 7 (4th Cir. 1960), 6 A.F.T.R. 2d 5233	Leaseholds
***Bonwit Teller & Co. v. Comr.*, 53 F. 2d 381 (2d Cir. 1931), 10 *A.F.T.R. 656*, cert. denied, 284 U.S. 690 (1932)**	Leaseholds
Handlery Hotels, Inc. v. U.S., 663 F.2d 892 (9th Cir. 1981)	Leaseholds
Island Creek Coal Co., 1962 P-H T.C. Memo Para. 62,138	Leaseholds
Midler Court Realty, Inc., 61 T.C. 590 (1974), aff'd, 521 F.2d 767 (3d Cir. 1974), 36 A.F.T.R. 2d 75-5567, acq., 1974-2 C.B. 3	Leaseholds
Cassatt v. Comr., 137 F.2d 745 (3d Cir. 1943)	Leases
***Comr. v. Moore*, 207 F.2d 265 (9th Cir. 1953), cert. denied, 347 U.S. 942 (1954)**	Leases
***Dairy Home Company v. U.S.*, 180 F. Supp. 92 (D. Minn. 1960)**	Leases
Elmira Arms Co., 7 B.T.A. 703 (1927)	Leases
Fieland v. Comr., 73 T.C. 743 (1980)	Leases
Forman, Inc. v. U.S., 89-1 USTC 9165 (D. Md. 1989)	Leases
Harris-Emery Co., 37 B.T.A. 958 (1938)	Leases
Latter v. Comr., T.C. Memo 1961-67	Leases
Metro Auto Auction of Kansas City, Inc. v. Comr., T.C. Memo 1984-440	Leases
Montgomery Co. v. Comr., 54 T.C. 986 (1970)	Leases
Peerless Weighing and Vending Co. v Comr., 52 T.C. 850 (1969)	Leases

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Sloan & Co. v. Comr., 38 T.C. 203 (1962)	Leases
***Soriano v. Comr.*, 90 T.C. 44 (1988), amd'd slip op. (T.C. Feb. 1, 1988)**	Leases
Trustee Corp. v. Comr., 42 T.C. 482 (1964), acq. 1966-2 C.B. 7	Leases
Bell v. Harrison, 212 F.2d 253 (7th Cir. 1954)	Life estates and terminable interests in property
***Comr. v. Fry*, 238 F.2d 869 (6th Cir. 1960)**	Life estates and terminable interests in property
Gist v. U.S., 296 F. Supp. 526 (1969), aff'd, 423 F.2d 1118 (9th Cir. 1970)	Life estates and terminable interests in property
Lomas Sante Fe, Inc. v. Comr., 74 T.C. 662 (1980), aff'd, 693 F.2d 71 (9th Cir. 1982), cert. denied, 460 U.S. 1083 (1983)	Life estates and terminable interests in property
***Nachman v. Comr.*, 191 F.2d 934 (5th Cir. 1951), 41 A.F.T.R. 172**	Liquor license
Tube Bar Inc., 15 T.C. 922 (1950)	Liquor license
William Zakin, 7 B.T.A. 687 (1927), nonacq., VII-2 C.B. 53	Liquor license
Zakon v. Comr., CCH Dec. 2625, 7 B.T.A. 687, 689 (1927)	Liquor license
Cottage Savings Assoc. v. Comr., 90 T.C. 372 (1988)	Loan participation contract
Griswold v. Comr., 45 T.C. 463 (1966), aff'd, 400 F.2d 427 (5th Cir. 1968)	Location leases
***Hoffman v. Comr.*, 48 T.C. 176 (1967), acq., 1972-2 C.B. 2**	Location leases
Sam Scalish, 1962 P-H T.C. Memo Para 62,046	Location leases
***Skilkin v. Comr.*, 50 T.C. 902 (1968), aff'd, 420 F.2d 266 (6th Cir. 1969)**	Location leases
***Meredith Publishing Co. v. Com.*, 64 F.2d 890, cert. denied 290 U.S. 646 (1933)**	Magazine & newspaper circulation
KFOX, Inc. v. U.S., 510 F.2d 1365 (Ct. Cl. 1975)	Management team
***Boe v. Comr.*, 35 T.C. 720 (1961), aff'd, 307 F.2d 339 (9th Cir. 1962)**	Medical service files
Estate of Tony Corderio, 51 T.C. 195 (1968)	Milk base (dairy herd)
Ralph Vander Hoek, 51 T.C. 203 (1968), acq., 1969-2 C.B. xxv	Milk base (dairy herd)
Gerrit Van De Steeg., 60 T.C. 17 (1973), aff'd, 510 F. 2d 961 (9th Cir. 1975), 35 A.F.T.R. 2d 75-816, no cert. (G), 1975 P-H Para. 61,000	Milk bases
Pevely Dairy Co., 1 B.T.A. 385 (1925), acq., IV-1 C.B. 3	Milk bases
Xavier Aphessetche v. Comr., 38 P-H T.C. Memo Para. 68,191(1968)	Milk bases
***Lang v. Comr.*, 36 T.C.M. 1194 (1977)**	Mineral rights
***Mills v. Comr.*, 17 T.C.M. 108 (1958)**	Mineral rights
Dakan v. U.S., 492 F.2d 1192 (Ct. Cl. 1974), 33 A.F.T.R. 2d 74-779	Mortgage servicing rights
First Nat'l Bank of Omaha, 1975 P-H T.C. Memo Para. 75.067	Mortgage servicing rights
***First Pennsylvania Banking & Trust Co. v. Comr.*, 56 T.C. 677 (1971), acq. 1972-1 C.B. 2**	Mortgage servicing rights
Robert E. Dakar, 492 F.2d 1192 (Ct. Cl. 1974), 33 A.F.T.R. 2d 74-779	Mortgage servicing rights
Securities-Intermountain, Inc. v. U.S., 70-1 USTC 9268, (D. Ore. 1970), aff'd, 460 F.2d 261 (9th Cir. 1972)	Mortgage servicing rights

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Western Mortgage Corp. v. U.S., 308 F.Supp. 333 (C.D. Cal. 1969)	Mortgage servicing rights
***Indiana Broadcasting Corp. v. Comr.*, 41 T.C. 793 (1964), rev'd, 350 F.2d 580 (7th Cir. 1965)**	Network affiliation contracts
Miami Valley Broadcasting Corp. v. U.S., 499 F.2d 677 (Ct. Cl. 1974)	Network affiliation contracts
Park Broadcasting, Inc. v. Comr., 78 T.C. 1093 (1982)	Network affiliation contracts
***Roy H. Park Broadcasting, Inc. v. Comr.*, 56 T.C. 784 (1971)**	Network affiliation contracts
***National Weeklies Inc. v. Reynolds*, 43 F. Supp. 554 (D.N. Minn. 1942)**	Newspaper subscription list
Successful Farming Publishing Co. v. Comr., 23 B.T.A. 150 (1931)	Newspaper subscription list
Burnet v. Niagara Falls Brewing Co., 282 U.S. 648 (1931)	Obsolescence
***George A. Hudspeth*, 394 F. Supp. 181 (N.D. Tex. 1975), 36 A.F.T.R. 2d 75-5009, aff'd, 519 F.2d 1055 (5th Cir. 1975), 36 A.F.T.R. 2d 75-5944**	Obsolescence
Fort Worth National Bank v. U.S., 75-1 U.S.T.C. ¶13,054	Oil royalties
Chandler Trailer Convoy, Inc., 1973 P-H T.C. Memo Para. 73,285	Operating rights
***Davison v. Comr.*, 1932 CCH ¶9409, 60 F. 2d 50, 52 (2d Cir 1932)**	Option to purchase
Allen Archery, Inc. v. Browning Mfg. Co., 898 F.2d 787 (Fed. Cir. 1990)	Patent
Allied Tube and Conduit Corp. v. Comr., T.C. Memo 1975 - 281.	Patent
***American Hoist & Derrick Co. v. Sowa & Sons*, 725 F.2d 1350, 1365 (Fed. Cir. 1984), cert. denied, 469 U.S. 821 (1984)**	Patent
American Original Corp. v. Jenkins Food Corp., 774 F.2d 459 (Fed. Cir. 1985)	Patent
Amstar Corp. v. Envirotech Corp., 823 F.2d 1538 (Fed. Cir. 1987)	Patent
Aro Mfg. Co. v. Convertible Top Co., 377 U.S. 476, 507 (1964)	Patent
Arriflex Corporation v. Aaton Cameras, Inc., 220 U.S.P.Q. 424 (S.D. N.Y. 1983)	Patent
***Atlantic Thermoplastics Co., Inc. v. Faytex Corp.*, 970 F.2d 834, (Fed. Cir. 1992)**	Patent
***Bandag, Inc. v. Gerrard Tire Company, Inc.*, 704 F.2d 1578, 1583 (Fed. Cir. 1983)**	Patent
***Baumstimler v. Rankin*, 677 F.2d 1061,1072 (5th Cir. 1982)**	Patent
***Beatrice Foods Co. v. New England Printing & Lithographing Co.*, 899 F.2d 1171, 1173 (Fed. Cir. 1990)**	Patent
***Beatrice Foods Co. v. New England Printing and Litho. Co.*, 923 F.2d 1576 (Fed. Cir. 1991)**	Patent
***BIC Leisure Prod. v. Windsurfing Int'l, Inc.*, 1 F.3d 1214 (Fed. Cir. 1993)**	Patent
***BIC Leisure Products, Inc. v. Windsurfing International, Inc.*, 761 F. Supp. 1032, (S.D.N.Y. 1991)**	Patent
***Bio-Rad Laboratories v. Nicolet Instrument Corp.*, 739 F.2d 604, 615-16 (Fed. Cir. 1984), cert. denied, 469 U.S. 1038 (1984)**	Patent
***Bio-Rad Laboratories, Inc. v. Nicolet Instrument Corp.*, 807 F.2d 964 (Fed. Cir. 1986), cert. denied, 482 U.S. 915 (1987)**	Patent
***Bockhoff v. Comr.*, 3 B.T.A. 560 (1926), acq. 1926-1 C.B. 2**	Patent
Boesch v. Graff, 133 U.S. 697, 706 (1890)	Patent

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***Bott v. Four Star Corp.*, 807 F.2d 1515 (Fed. Cir. 1986)**	Patent
***Brooktree Corp. v. Advanced Micro Devices, Inc.*, 977 F.2d 1555 (Fed. Cir. 1992)**	Patent
Busse v. U.S., 77-2 U.S.T.C. ¶9753	Patent
***Carella v. Starlight Archery & Pro Line Co.*, 804 F.2d 135, 141 (Fed. Cir. 1986)**	Patent
***Central Soya Co. v. Geo. A. Hormel & Co.*, 723 F.2d 1573, 1578 (Fed. Cir. 1983)**	Patent
***Chevron Chemical Co. v. Voluntary Purchasing Groups, Inc.*, 659 F.2d 695 (5th Cir. 1981), cert. denied, 457 U.S. 1126 (1982)**	Patent
***Comair Rotron, Inc. v. Nippon Densan Corp.*, 49 F.3d 1535 (Fed. Cir. 1995)**	Patent
***Comr. v. Chamberlin*, 32 T.C. 1098 (1959), aff'd 286 F.2d 850 (7th Cir. 1960), cert. denied, 368 U.S. 820 (1961)**	Patent
***CVI/Beta Ventures, Inc. v. Tura* LP, 905 F. Supp. 1171 (E.D.N.Y. 1995)**	Patent
***Datascope Corp. v. SMEC, Inc.*, 879 F.2d 820, (Fed. Cir. 1989), cert. denied, 493 U.S. 1024**	Patent
Deepsouth Packing Co. v. Laitram Corp., 406 U.S. 518 (1972)	Patent
***Deere & Co. v. International Harvester Co.*, 710 F.2d 1551, 1554, 1558-9 (Fed. Cir. 1983)**	Patent
***Del Mar Avionics, Inc. v. Quinton Instrument Co.*, 836 F.2d 1320, 1326 (Fed. Cir. 1987)**	Patent
***Devex Corp. v. General Motors Corp.*, 494 F. Supp. 1369, 1377 (D. Del, 1980), aff'd 667 F.2d 347 (3d Cir. 1981), aff'd 461 U.S. 648 (1983)**	Patent
***Egry Register Co. v. Standard Register Co.*, 23 F. 2d 438, 443 (6th Cir. 1928)**	Patent
***Estate of Marsack v. Comr.*, 19 T.C.M. 398 (1960), aff'd 288 F.2d 533 (7th Cir. 1961)**	Patent
***Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd.*, 72 F.3d 857, 867 (Fed. Cir. 1995)**	Patent
***Fromson v. Western Litho Plate and Supply Co.*, 853 F.2d 1568, (Fed. Cir. 1988)**	Patent
General Motors Corp. v. Devex Corp., 461 U.S. 648 (1983)	Patent
***Georgia-Pacific v. United States Plywood Corp.*, 318 F. Supp. 1116, (S.D.N.Y. 1970), modif'd 446 F.2d 295 (2d Cir. 1971), cert. denied 404 U.S. 870 (1971)**	Patent
***Goodyear Tire and Rubber Co. v. Overman Cushion Tire Co.*, 95 F. 2d 978, 984 (6th Cir. 1937), cert. dismissed 306 U.S. 665 (1939)**	Patent
***Graham v. John Deere Co.*, 383 U.S. 1 (1966)**	Patent
***Gyromat Corp. v. Champion Spark Plug Co.*, 735 F.2d 549, 551 (Fed. Cir. 1984)**	Patent
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***Hartness International, Inc. v. Simplimatic Engineering Co.*, 819 F.2d 1100 (Fed. Cir. 1987)**	Patent
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***Hoy v. Comr.*, 17 T.C.M. 115 (1958)**	Patent
***Hughes Tool Co. v. Dresser Industries, Inc.*, 816 F.2d 1549 (Fed. Cir. 1987), cert. denied 484 U.S. 914 (1987)**	Patent
***In re Mahurkar Patent Litigation*, 831 F. Supp. 1354 (N.D. Ill. 1993), aff'd, 71 F.3d 1573 (Fed. Cir. 1995)**	Patent
***Jenn-Air Corp. v. Penn Ventilation Co.*, 394 F. Supp. 665, 676 (E.D. Pa. 1975)**	Patent
***Kalman v. The Berlyn Corp.*, 914 F.2d 1473, 1485 (Fed. Cir. 1990)**	Patent
***Kaufman Co. v. Lantech, Inc.*, 926 F.2d 1136, 1141, (Fed. Cir. 1991)**	Patent
***Kearns v. Chrysler Corp.*, 32 F.3d 1541 (Fed. Cir. 199_*), cert. denied, 1155 Ct. 1392 (1995)**	Patent
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***King Instrument Corp. v. Otari Corp.*, 767 F.2d 853, 864, (Fed. Cir. 1985), cert. denied, 475 U.S. 1016 (1986)**	Patent
***King Instruments Corp. v. Perego*, 65 F.3d 941, 952 (Fed. Cir. 1995), cert. denied, 1165 Ct. 1675 (1996)**	Patent
***Kori Corp. v. Wilco Marsh Buggies & Draglines, Inc.*, 761 F.2d 649, 653, (Fed. Cir. 1985), cert. denied, 474 U.S. 902 (1985)**	Patent
***Kraft Foods Co., v. Comr.*, 21 T.C. 513 (1954), rev'd 1232 F.2d 118 (2d Cir. 1956)**	Patent
***Laitram Corp. v. Cambridge Wire Cloth Co.*, 785 F.2d 292 (Fed. Cir. 198_*), cert. denied, 479 U.S. 820 (1986)**	Patent
***Lam, Inc. v. Johns-Manville Corp.*, 718 F.2d 1056 (Fed. Cir. 1983)**	Patent
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***Lindemann Maschinenfabrik GmbH v. American Hoist & Derrick Co.*, 895 F.2d 1403, 1406 (Fed. Cir. 1990)**	Patent
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***Milgo Electronics Corp. v. United Business Communications, Inc.*, 623 F.2d 645, 663 (10th Cir. 1980), cert. denied, 449 U.S. 1066 (1980)**	Patent

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***Mobil Oil Corp. v. Amoco Chemicals Corp.*, 915 F. Supp. 1333 (D. Del. 1995)**	Patent
***Nickson Industries Inc. v. Rol Mfg. Co. Ltd.*, 847 F.2d 795, 798 (Fed. Cir. 1988)**	Patent
***Orthman Mfg. Inc. v. Chromalloy American Corp.*, 512 F. Supp. 1284 (C.D. Ill. 1981)**	Patent
***Pall Corp. v. Micron Separations, Inc.* 66 F.3d 1211 (Fed. Cir. 1995)**	Patent
Panduit Corp. v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152,1156 (6th Cir. 1978)	Patent
***Paper Converting Mach. Co. v. Magna-Graphics Corp.*, 745 F.2d 11, 22, (Fed. Cir. 1984)**	Patent
***Pfizer, Inc. v. International Rectifier Corp.*, 218 U.S.P.Q. 586 (C.D. Cal. 1983)**	Patent
***Pitcairn v. U.S.*, 547 F.2d 1106, 1118 (Ct. Cl. 1976)**	Patent
***Polaroid Corp. v. Eastman Kodak Co.*, 16 U.S.P.Q.2d. 1481, 1535, (D. Mass. 1990), amd'd, 17 U.S. P.Q.2d 1711 (D. Mass. 1991)**	Patent
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***Rawlplug Co. Inc. v. Illinois Tool Works, Inc.* 1994 U.S. Dist. Lexis 7148, (S.D.N.Y. 1994)**	Patent
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***Rite-Hite Corp. v. Kelley Co., Inc.*, 56 F.3d 1538 (Fed. Cir. 1995), cert. denied, 116 S. Ct. 184 (1995)**	Patent
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***Standard Havens Prods., Inc. v. Genco Indus., Inc.*, 953 F.2d 1360 (Fed. Cir. 1991), cert. denied, 506 U.S. 817 (1992)**	Patent
***State Indus., Inc. v. Mor-Flo Indus., Inc.*, 883 F.2d 1573, 1579, (Fed. Cir. 1989), cert. denied, 493 U.S. 1022 (1990)**	Patent
Stickle v. Heublein, Inc., 716 F.2d 1550, 1561 (Fed. Cir. 1983)	Patent
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***Studiengesellschaft Kohle, v. Dart Industries, Inc.*, 862 F.2d 1564, 1579-80 (Fed. Cir. 1988)**	Patent
***Sun Studs, Inc. v. ATA Equipment Leasing, Inc.*, 872 F.2d 978 (Fed. Cir. 1989)**	Patent
Tektronix, Inc. v. United States, 552 F.2d 343, 347 (Ct. Cl. 1977)	Patent
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***Trio Process Corp. v. L. Goldstein's Sons, Inc.*, 533 F.2d 126, 129 (3d Cir. 1976)**	Patent
***TWM Manufacturing Co., Inc. v. Dura Corp.*, 789 F.2d 895 (Fed. Cir. 1986), cert. denied, 479 U.S. 852 (1986)**	Patent
***Underwater Devices Inc. v. Morrison-Knudsen Co.*, 717 F.2d 1380 (Fed. Cir. 1983)**	Patent
***Uniroyal, Inc. v. Rudkin-Wiley Corp.*, 939 F.2d 1540 (Fed. Cir. ____*)**	Patent
***Unisplay S.A. v. American Electronic Sign Co.*, 69 F.3d 512 (Fed. Cir. 1995)**	Patent
***Wang Labs Inc. v. Mitsubishi Electronics America, Inc.*, 860 F. Supp. 1448 (C.D. Cal. 1993)**	Patent
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Falstaff Beer Inc. v. Comr. 322 F.2d 744 (5th Cir. 1963), 12 A.F.T.R. 2d 5650	Payments to obtain peaceful transition and prevent competing or interfering with market
***Comr. v. Chicago National League Ball Club*, 74 F.2d 1010 (7th Cir. 1935)**	Player contracts
***Comr. v. Pittsburg Athletic Co.*, 72 F.2d 883 (3d Cir. 1934)**	Player contracts

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***Kansas City American Baseball Assn. Co.*, 75 F.2d 600 (8th Cir. 1935), 15 A.F.T.R. 258**	Player contracts
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Arrowsmith v. Comr., 344 U.S. 6 (1952)	Post-closing adjustments to consideration : "arrowsmith" doctrine
Gerrit B. Lemmem, 77 T.C. 1326 (1981)	Premium paid for cattle
***Seaboard Fin. Co.*, 367 F.2d 646 (9th Cir. 1966), 18 A.F.T.R. 2d 5803**	Premium to acquire loan accounts
***Comr. v. Lincoln Savings and Loan Assoc.*, 403 U.S. 345 (1971)**	Prepaid deposit insurance
Ida Ambrose, 25 P-H T.C. Memo Para. 56, 125 (1956)	Purchase contract
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***Pensacola Greyhound Racing, Inc. v. Comr.*, CCH Dec. 32,173 (M), 32 T.C.M. 1064, 1069 (1973)**	Racing license
Chronicle Publishing Co. v. Comr., 67 T.C. 964 (1977); nonacq., 1980-2 C.B. 2	Radio and TV franchises
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***Manchester Board and Paper Co. v. Comr.*, 35-1 USTC ¶9057, 74 F.2d 838, 840 (4th Cir. 1935)**	Renewal privilege
Salome, Jr. v. U.S., 395 F.2d 990 (5th Cir. 1968), 22 A.F.T.R. 2d 5039	Renewals
Bilar Tool and Die Corp., 62 T.C. 213 (1974), rev'd, 530 F.2d 708 (6th Cir. 1976), 37 A.F.T.R. 2d 76-850	Reorganization expenses
***El Paso Natural Gas Co.*, 48 A.F.T.R. 2d 81-5473 (Fed. Cir. 1981), mod's, 694 F.2d 703 (Ct. Cl. 1982), 51 A.F.T.R. 2d 83-451**	Reorganization expenses
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***Snow v. Comr.*, 482 F.2d 1029(1973), 32 A.F.T.R. 2d 73-5400, rev'd, 416 U.S. 500 (1974)**	Research and experimental
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Mattie Fair, 27 T.C. 866 (1957), acq., 1957-2 C.B. 4	Right to build over taxpaper's property
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***First Northwest Industries of America v. Comr.*, 70 T.C. 817 (1978); rev'd and rem'd on other issues, 649 F.2d 707 (9th Cir. 1981)**	Sports franchises
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Danville Press, Inc. v. Comr., 1 B.T.A. 1171 (1925)	Subscriptions
***Florida Publishing Co.*, 64 T.C. 269 (1975), aff'd, 552 F.2d 367 (5th Cir. 1977)**	Subscriptions
Houston Chronicle Publishing Co. v. U.S., 481 F.2d 1240 (5th Cir. 1973), cert. denied, 414 U.S. 1129 (1974)	Subscriptions
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***Alpo v. Ralston-Purina*, 997 F.2d 949 (D.C. Cir. 1993)**	Trademark
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***Pohlen v. Comr.*, 165 F.2d 258 (5th Cir. 1948)**	Various intangibles
***Estate of Goodrich v. Comr.* 37 T.C.M. 1062 (1978)**	Voting trust

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   Unfamiliar Somewhat familiar My area of expertise

2. How useful is the Practice Aid to your practice?
   0 1 2 3 4 5
   Not useful at all Extremely useful

3. Is there additional information that you think should have been included or information that should be modified in this Practice Aid? Yes _____ No _____

If yes, please explain. ______________________________

____

____

4. Do you think that an advanced level Practice Aid on this subject should be available?
   Yes _____ No _____

5. What other subjects would you like to see covered in Consulting Services Practice Aids?

____

____

6. How did you learn about the availability of this Practice Aid?
   Received it as a member benefit _____
   Other (please explain) ______________________________

____

Additional comments and suggestions ______________________________

____

____

Name and address (optional) ______________________________

____

CONSULTING SERVICES MEMBERSHIP SECTION

The Consulting Services (CS) Section serves members who provide business counseling and other management consulting services to for-profit, not-for-profit, and government organizations. Whether you're a relative newcomer or have long-time experience, membership in the CS Section can benefit you.

UNIQUE CS SECTION BENEFITS:

Publications

- A copy of each new Statement on Standards for Consulting Services when it is issued.
- To support its members, the CS Section offers an extensive list of technical, small business, and industry consulting practice aids; practice administration aids; special reports; and other publications. Members automatically receive each new practice aid and special report.
- Timely alerts of vital information on issues impacting your practice, such as pending legislation.

Section Newsletters—Every quarter, CS Section members receive *CPA Management Consultant,* a newsletter written by consultants for consultants. Every issue explores emerging issues and services to help CPAs recognize opportunities for consulting services engagements. Membership also gives you an opportunity to share ideas with other CPA consultants, by contributing articles to the newsletter or becoming involved in the development of CS practice aids or other publications. Members also receive a 50% discount on *CPA Expert,* a newsletter for providers of business valuation and litigation services.

Peer Network—You can participate in the Section's Database Referral System, putting you in contact with other Section members who have expertise in various technical areas and industries.

Vendor Discounts—Section members are eligible for vendor discounts on hardware, software, and numerous other products designed to make consulting work easier.

Special Projects and Activities—The section is involved in ongoing projects designed to help CS practitioners keep up with current trends and developments in the field. It also monitors proposed legislation that might impact practitioners and the services they provide.

Please enroll me as a member of the AICPA Consulting Services Section through July 31. I am returning this form along with my check for $100 payable to AICPA. I understand that the $100 annual fee is prorated* through July 31, and that it covers all membership benefits. (Membership dues cannot be prorated for less than $50, half the *regular* annual dues amount.)

Member Name AICPA MEMBER NUMBER

Firm

Address

City State Zip

Telephone Fax Number

Signature

*Prorated dues 8/1-10/31 $100, 11/1-1/31 $75, 2/1-7/31 $50

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